FOOT LOCKER INC
Form 10-K
March 31, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

For the fiscal year ended February 2, 2008

Commission file number 1-10299

FOOT LOCKER, INC.
(Exact name of Registrant as specified in its charter)

New York	**13-3513936**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
112 West 34th Street, New York, New York	**10120**
(Address of principal executive offices)	*(Zip Code)*

Registrant's telephone number, including area code:
(212) 720-3700

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value $0.01	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
None

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

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

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

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

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 the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x Accelerated filer o Non-accelerated filer o Smaller reporting company o

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

See pages 68 through 71 for Index of Exhibits.

Number of shares of Common Stock outstanding at March 27, 2008:		154,632,279
The aggregate market value of voting stock held by non-affiliates of the Registrant computed by reference to the closing price as of the last business day of the Registrant s most recently completed second fiscal quarter, August 4, 2007, was approximately:	$	2,444,288,194*

* For purposes of this calculation only (a) all directors plus one executive officer and owners of five percent or more of the Registrant are deemed to be affiliates of the Registrant and (b) shares deemed to be held by such persons at August 4, 2007 include only outstanding shares of the Registrant s voting stock with respect to which such persons had, on such date, voting or investment power.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant s definitive Proxy Statement (the Proxy Statement) to be filed in connection with the Annual Meeting of Shareholders to be held on May 21, 2008: Parts III and IV.

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PART I

Item 1. Business

General

Foot Locker, Inc., incorporated under the laws of the State of New York in 1989, is a leading global retailer of athletic footwear and apparel, operating 3,785 primarily mall-based stores in the United States, Canada, Europe, Australia, and New Zealand as of February 2, 2008. Foot Locker, Inc. and its subsidiaries hereafter are referred to as the “Registrant,” “Company” or “we.” Information regarding the business is contained under the “Business Overview section in “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

The Company maintains a website on the Internet at *www.footlocker-inc.com*. The Company’s filings with the Securities and Exchange Commission, including its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports are available free of charge through this website as soon as reasonably practicable after they are filed with or furnished to the SEC by clicking on the “SEC Filings” link. The Corporate Governance section of the Company’s corporate website contains the Company’s Corporate Governance Guidelines, Committee Charters, and the Company’s Code of Business Conduct for directors, officers and employees, including the Chief Executive Officer, Chief Financial Officer and Chief Accounting Officer. Copies of these documents may also be obtained free of charge upon written request to the Company’s Corporate Secretary at 112 West 34th Street, New York, NY 10120. The Company intends to disclose promptly amendments to the Code of Business Conduct and waivers of the Code for directors and executive officers on the corporate governance section of the Company’s corporate website.

The Certification of the Chief Executive Officer required by Section 303A.12(a) of The New York Stock Exchange Listing Standards relating to the Company’s compliance with The New York Stock Exchange Corporate Governance Listing Standards was submitted to The New York Stock Exchange on June 8, 2007.

Information Regarding Business Segments and Geographic Areas

The financial information concerning business segments, divisions and geographic areas is contained under the “Business Overview” and “Segment Information” sections in “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations.” Information regarding sales, operating results and identifiable assets of the Company by business segment and by geographic area is contained under the “Segment Information” footnote in “Item 8. Consolidated Financial Statements and Supplementary Data.”

The service marks and trademarks appearing on this page and elsewhere in this report (except for ESPN, Nike, Amazon.com, Weekend Edition, The San Francisco Music Box Company, and USOC) are owned by Foot Locker, Inc. or its subsidiaries.

Employees

The Company and its consolidated subsidiaries had 16,839 full-time and 27,576 part-time employees at February 2, 2008. The Company considers employee relations to be satisfactory.

Competition

Financial information concerning competition is contained under the "Business Risk" section in the "Financial Instruments and Risk Management" footnote in "Item 8. Consolidated Financial Statements and Supplementary Data."

Merchandise Purchases

Financial information concerning merchandise purchases is contained under the "Liquidity" section in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and under the "Business Risk" section in the "Financial Instruments and Risk Management" footnote in "Item 8. Consolidated Financial Statements and Supplementary Data."

Item 1A. Risk Factors

The statements contained in this Annual Report on Form 10-K ("Annual Report") that are not historical facts, including, but not limited to, statements regarding our expected financial position, business and financing plans found in "Item 1. Business" and "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations," constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. The words "may," "believes," "expects," "plans," "intends," "anticipates" and similar expressions id forward-looking statements. The actual results of the future events described in these forward-looking statements could differ materially from those stated in the forward-looking statements.

Our actual results may differ materially due to the risks and uncertainties discussed in this Annual Report, including those discussed below. Additional risks and uncertainties that we do not presently know about or that we currently consider to be insignificant may also affect our business operations and financial performance. Accordingly, readers of the Annual Report should consider these risks and uncertainties in evaluating the information and are cautioned not to place undue reliance on the forward-looking statements contained herein. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

The industry in which we operate is dependent upon fashion trends, customer preferences and other fashion-related factors.

The athletic footwear and apparel industry is subject to changing fashion trends and customer preferences. We cannot guarantee that our merchandise selection will accurately reflect customer preferences when it is offered for sale or that we will be able to identify and respond quickly to fashion changes, particularly given the long lead times for ordering much of our merchandise from vendors. For example, we order the bulk of our athletic footwear four to six months prior to delivery to our stores. If we fail to anticipate accurately either the market for the merchandise in our stores or our customers' purchasing habits, we may be forced to rely on markdowns or promotional sales to dispose of excess, slow moving inventory, which could have a material adverse effect on our business, financial condition, and results of operations.

A substantial portion of our highest margin sales are to young males (ages 12–25), many of whom we believe purchase athletic footwear and licensed apparel as a fashion statement and are frequent purchasers of athletic footwear. Any shift in fashion trends that would make athletic footwear or licensed apparel less attractive to these customers could have a material adverse effect on our business, financial condition, and results of operations.

The businesses in which we operate are highly competitive.

The retail athletic footwear and apparel business is highly competitive with relatively low barriers to entry. Our athletic footwear and apparel operations compete primarily with athletic footwear specialty stores, sporting goods stores and superstores, department stores, discount stores, traditional shoe stores, and mass merchandisers, many of which are units of national or regional chains that have significant financial and marketing resources. The principal competitive factors in our markets are price, quality, selection of merchandise, reputation, store location, advertising, and customer service. We cannot assure you that we will continue to be able to compete successfully against existing or future competitors. Our expansion into markets served by our competitors and entry of new

competitors or expansion of existing competitors into our markets could have a material adverse effect on our business, financial condition, and results of operations.

Although we sell merchandise via the Internet, a significant shift in customer buying patterns to purchasing athletic footwear, athletic apparel, and sporting goods via the Internet could have a material adverse effect on our business results. In addition, some of our vendors distribute products directly through the Internet and others may follow. Some vendors operate retail stores and some have indicated that further retail stores will open. Should this continue to occur, and if our customers decide to purchase directly from our vendors, it could have a material adverse effect on our business, financial condition, and results of operations.

We depend on mall traffic and our ability to identify suitable store locations.

Our sales, particularly in the United States and Canada, are dependent in part on a high volume of mall traffic. Our stores are located primarily in enclosed regional and neighborhood malls. Mall traffic may be adversely affected by, among other things, economic downturns, the closing of anchor department stores or changes in customer preferences or acts of terrorism. A decline in the popularity of mall shopping among our target customers could have a material adverse effect on us.

To take advantage of customer traffic and the shopping preferences of our customers, we need to maintain or acquire stores in desirable locations such as in regional and neighborhood malls anchored by major department stores. We cannot be certain that desirable mall locations will continue to be available.

The effects of natural disasters, terrorism, acts of war and retail industry conditions may adversely affect our business.

Natural disasters, including hurricanes, floods, and tornados may affect store and distribution center operations. In addition, acts of terrorism, acts of war, and military action both in the United States and abroad can have a significant effect on economic conditions and may negatively affect our ability to purchase merchandise from vendors for sale to our customers. Any significant declines in general economic conditions, public safety concerns or uncertainties regarding future economic prospects that affect customer spending habits could have a material adverse effect on customer purchases of our products.

A change in the relationship with any of our key vendors or the unavailability of our key products at competitive prices could affect our financial health.

Our business is dependent to a significant degree upon our ability to purchase brand-name merchandise at competitive prices, including the receipt of volume discounts, cooperative advertising, and markdown allowances from our vendors. The Company purchased approximately 77 percent of its merchandise in 2007 from its top five vendors and expects to continue to obtain a significant percentage of its athletic product from these vendors in future periods. Approximately 56 percent was purchased from one vendor Nike, Inc. (Nike). Each of our operating divisions is highly dependent on Nike; they individually purchase 43 to 74 percent of their merchandise from Nike. We have no long-term supply contracts with any of our vendors. Our inability to obtain merchandise in a timely manner from major suppliers (particularly Nike) as a result of business decisions by our suppliers or any disruption in the supply chain could have a material adverse effect on our business, financial condition, and results of operations. Because of our strong dependence on Nike, any adverse development in Nikes financial condition and results of operations or the inability of Nike to develop and manufacture products that appeal to our target customers could also have an adverse effect on our business, financial condition, and results of operations. We cannot be certain that we will be able to acquire merchandise at competitive prices or on competitive terms in the future.

Merchandise that is high profile and in high demand is allocated by our vendors based upon their internal criteria. Although we have generally been able to purchase sufficient quantities of this merchandise in the past, we cannot be certain that our vendors will continue to allocate sufficient amounts of such merchandise to us in the future. In addition, our vendors provide support to us through cooperative advertising allowances and promotional events. We cannot be certain that such assistance from our vendors will continue in the future. These risks could have a material adverse effect on our business, financial condition, and results of operations.

We may experience fluctuations in and cyclicality of our comparable-store sales results.

Our comparable-store sales have fluctuated significantly in the past, on both an annual and a quarterly basis, and we expect them to continue to fluctuate in the future. A variety of factors affect our comparable-store sales results, including, among others, fashion trends, the highly competitive retail store sales environment, economic conditions, timing of promotional events, changes in our merchandise mix, calendar shifts of holiday periods, and weather conditions.

Many of our products, particularly high-end athletic footwear and licensed apparel, represent discretionary purchases. Accordingly, customer demand for these products could decline in a recession or if our customers develop other priorities for their discretionary spending. These risks could have a material adverse effect on our business, financial condition, and results of operations.

Our operations may be adversely affected by economic or political conditions in other countries.

Approximately 27 percent of our sales and a significant portion of our operating results for 2007 were attributable to our sales in Europe, Canada, New Zealand, and Australia. As a result, our business is subject to the risks associated with doing business outside of the United States, such as foreign governmental regulations, foreign customer preferences, political unrest, disruptions or delays in shipments, and changes in economic conditions in countries in which we operate. Although we enter into forward foreign exchange contracts and option contracts to reduce the effect of foreign currency exchange rate fluctuations, our operations may be adversely affected by significant changes in the value of the U.S. dollar as it relates to certain foreign currencies.

In addition, because we and our suppliers have a substantial amount of our products manufactured in foreign countries, our ability to obtain sufficient quantities of merchandise on favorable terms may be affected by governmental regulations, trade restrictions, and economic, labor, and other conditions in the countries from which our suppliers obtain their product.

Our business is subject to economic cycles and retail industry conditions. Purchases of discretionary athletic footwear, apparel, and related products, tend to decline during recessionary periods when disposable income is low and customers are hesitant to use available credit.

Complications in our distribution centers and other factors affecting the distribution of merchandise may affect our business.

We operate four distribution centers worldwide to support our athletic business. In addition to the distribution centers that we operate, we have additional third-party arrangements related to our operations in Canada, Australia and New Zealand. If complications arise with any facility or any facility is severely damaged or destroyed, the other distribution centers may not be able to support the resulting additional distribution demands. This may adversely affect our ability to deliver inventory on a timely basis. We depend upon UPS for shipment of a significant amount of merchandise. An interruption in service by UPS for any reason could cause temporary disruptions in our business, a loss of sales and profits, and other material adverse effects.

Our freight cost is affected by changes in fuel prices through surcharges. Increases in fuel prices and surcharges and other factors may increase freight costs and thereby increase our cost of sales.

A major failure of our information systems could harm our business.

We depend on information systems to process transactions, manage inventory, operate our website, purchase, sell and ship goods on a timely basis and maintain cost-efficient operations. Any material disruption or slowdown of our systems could cause information to be lost or delayed which could have a negative effect on our business. We may experience operational problems with our information systems as a result of system failures, viruses, computer hackers or other causes. We cannot be assured that our systems will be adequate to support future growth.

Unauthorized disclosure of sensitive or confidential customer information, whether through a breach of the Company’s computer system or otherwise, could severely harm our business.

As part of the Company’s normal course of business, it collects, processes, and retains sensitive and confidential customer information. Despite the security measurers the Company has in place, its facilities and systems may be vulnerable to security breaches, acts of vandalism, computer viruses, misplaced or lost data, programming and/or human error, or other similar events. Any security breach involving the misappropriation, loss or other unauthorized disclosure of confidential information by the Company could severely damage its reputation, expose it to the risks of litigation and liability, disrupt its operations and harm its business.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The properties of the Company and its consolidated subsidiaries consist of land, leased and owned stores, and administrative and distribution facilities. Gross operating square footage and total selling area for the Athletic Stores segment at the end of 2007 was approximately 14.12 and 8.50 million square feet, respectively. These properties, which are primarily leased, are located in the United States, Canada, various European countries, Australia, and New Zealand.

The Company currently operates four distribution centers, of which two are owned and two are leased, occupying an aggregate of 2.54 million square feet. Three of the four distribution centers are located in the United States and one is in Europe.

Item 3. Legal Proceedings

Information regarding the Company’s legal proceedings are contained in the “Legal Proceedings” footnote under “Item 8. Consolidated Financial Statements and Supplementary Data.”

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

There were no matters submitted to a vote of security holders during the fourth quarter of the year ended February 2, 2008.

Executive Officers of the Company

Information with respect to Executive Officers of the Company, as of March 31, 2008, is set forth below:

Chairman of the Board, President and Chief Executive Officer	Matthew D. Serra
President and Chief Executive Officer - Foot Locker, Inc. – International	Ronald J. Halls
President and Chief Executive Officer - Foot Locker, Inc. – U.S.A.	Richard T. Mina
Senior Vice President, General Counsel and Secretary	Gary M. Bahler
Senior Vice President – Real Estate	Jeffrey L. Berk
Senior Vice President, Chief Information Officer and Investor Relations	Peter D. Brown
Senior Vice President and Chief Financial Officer	Robert W. McHugh
Senior Vice President – Strategic Planning	Lauren B. Peters
Senior Vice President – Human Resources	Laurie J. Petrucci
Vice President and Chief Accounting Officer	Giovanna Cipriano
Vice President and Treasurer	John A. Maurer

Matthew D. Serra, age 63, has served as Chairman of the Board since February 2004, President since April 2000 and Chief Executive Officer since March 2001. Mr. Serra served as Chief Operating Officer from February 2000 to March 2001 and as President and Chief Executive Officer of Foot Locker Worldwide from September 1998 to February 2000.

Ronald J. Halls, age 54, has served as President and Chief Executive Officer of Foot Locker, Inc.- International since October 2006. He served as President and Chief Executive Officer of Champs Sports, an operating division of the Company, from February 2003 to October 2006 and as Chief Operating Officer of Champs Sports from February 2000 to February 2003.

Richard T. Mina, age 51, has served as President and Chief Executive Officer of Foot Locker, Inc.- U.S.A. since February 2003. He served as President and Chief Executive Officer of Champs Sports, an operating division of the Company, from April 1999 to February 2003.

Gary M. Bahler, age 56, has served as Senior Vice President since August 1998, General Counsel since February 1993 and Secretary since February 1990.

Jeffrey L. Berk, age 52, has served as Senior Vice President — Real Estate since February 2000.

Peter D. Brown, age 53, has served as Senior Vice President, Chief Information Officer and Investor Relations since September 2006. Mr. Brown served as Vice President — Investor Relations and Treasurer from October 2001 to September 2006, served as Vice President — Investor Relations and Corporate Development from April 2001 to October 2001 and as Assistant Treasurer — Investor Relations and Corporate Development from August 2000 to April 2001.

Robert W. McHugh, age 49, has served as Senior Vice President and Chief Financial Officer since November 2005. He served as Vice President and Chief Accounting Officer from January 2000 to November 2005.

Lauren B. Peters, age 46, has served as Senior Vice President — Strategic Planning since April 2002. Ms. Peters served as Vice President — Planning from January 2000 to April 2002.

Laurie J. Petrucci, age 49, has served as Senior Vice President — Human Resources since May 2001. Ms. Petrucci served as Senior Vice President — Human Resources of the Foot Locker Worldwide division from March 2000 to May 2001.

Giovanna Cipriano, age 38, has served as Vice President and Chief Accounting Officer since November 2005. She served as Divisional Vice President, Financial Controller from June 2002 to November 2005 and as Financial Controller from April 1999 to June 2002.

John Maurer, age 48, has served as Vice President and Treasurer since September 2006. Mr. Maurer served as Assistant Treasurer from April 2002 to September 2006.

There are no family relationships among the executive officers or directors of the Company.

PART II

Item 5. Market for the Company's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Information regarding the Company's market for stock exchange listings, common equity, quarterly high and low prices, and dividend policy are contained in the "Shareholder Information and Market Prices" footnote under "Item 8. Consolidated Financial Statements and Supplementary Data."

On March 7, 2007, the Company announced that its Board of Directors authorized a new $300 million, three-year share repurchase program replacing the earlier $150 million program. Under the share repurchase program, subject to legal and contractual restrictions, the Company may make purchases of its common stock from time to time, depending on market conditions, availability of other investment opportunities and other factors. In October 2007, the Company amended its revolving credit agreement. With regard to stock repurchases, the amendment provides that not more than $50 million in the aggregate may be expended after October 26, 2007 unless the fixed charge coverage ratio is at least 2.0:1 for the quarter immediately preceding any such repurchase and the Company has delivered its annual audited financial statements with respect to 2007. During 2007, the Company repurchased 2,283,254 shares of common stock at a cost of approximately $50 million. There were no purchases of common stock during the fourth quarter of 2007.

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Performance Graph

The following graph compares the cumulative five-year total return to shareholders on Foot Locker, Inc.s common stock relative to the total returns of the Russell 2000 Index and a selected peer group, which represents its peers as retailers in the athletic footwear and apparel industry. The peer group comprises:

- Dicks Sporting Goods, Inc.
- The Finish Line, Inc.
- Hibbett Sporting Goods, Inc., and
- Genesco, Inc., whose business includes operations outside of the athletic footwear and apparel retailing.

Indexed Share Price Performance

The Company has historically constructed a selected peer group in its performance graph. However, due to the declining number of public company peers in the athletic footwear and apparel industry, the Company has determined it would be more appropriate to use the S&P 400 Retailing Index, rather than the selected peer group. The next graph compares the cumulative five-year total shareholder return on our common stock against the cumulative five-year total return of the S&P 400 Retailing Index and the Russell 2000 Index.

Indexed Share Price Performance

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Item 6. Selected Financial Data

Selected financial data is included as the Five Year Summary of Selected Financial Data footnote in Item 8. Consolidated Financial Statements and Supplementary Data.

Item 7. Managements Discussion and Analysis of Financial Condition and Results of Operations

Business Overview

Foot Locker, Inc., through its subsidiaries, operates in two reportable segments Athletic Stores and Direct-to-Customers. The Athletic Stores segment is one of the largest athletic footwear and apparel retailers in the world, whose formats include Foot Locker, Lady Foot Locker, Kids Foot Locker, Champs Sports, and Footaction. The Direct-to-Customers segment reflects Footlocker.com, Inc., which sells, through its affiliates, including Eastbay, Inc., to customers through catalogs and Internet websites.

The Foot Locker brand is one of the most widely recognized names in the market segments in which the Company operates, epitomizing high quality for the active lifestyle customer. This brand equity has aided the Company's ability to successfully develop and increase its portfolio of complementary retail store formats, specifically Lady Foot Locker and Kids Foot Locker, as well as Footlocker.com, Inc., its direct-to-customers business. Through various marketing channels, including television campaigns and sponsorships of various sporting events, Foot Locker, Inc. reinforces its image with a consistent message; namely, that it is the destination store for athletic footwear and apparel with a wide selection of merchandise in a full-service environment.

Athletic Stores

The Company operates 3,785 stores in the Athletic Stores segment. The following is a brief description of the Athletic Stores segment's operating businesses:

Foot Locker — Foot Locker is a leading athletic footwear and apparel retailer. Its stores offer the latest in athletic-inspired performance products, manufactured primarily by the leading athletic brands. Foot Locker offers products for a wide variety of activities including running, basketball, hiking, tennis, aerobics, fitness, baseball, football, and soccer. Its 2,006 stores are located in 21 countries including 1,275 in the United States, Puerto Rico, and Guam, 130 in Canada, 509 in Europe and a combined 92 in Australia and New Zealand. The domestic stores have an average of 2,500 selling square feet and the international stores have an average of 1,500 selling square feet.

Champs Sports — Champs Sports is one of the largest mall-based specialty athletic footwear and apparel retailers in the United States. Its product categories include athletic footwear, apparel and accessories, and a focused assortment of equipment. This combination allows Champs Sports to differentiate itself from other mall-based stores by presenting complete product assortments in a select number of sporting activities. Its 576 stores are located throughout the United States, Canada, and the U.S. Virgin Islands. The Champs Sports stores have an average of 3,700 selling square feet.

Footaction — Footaction is a national athletic footwear and apparel retailer. The primary customers are young urban males that seek street-inspired fashion styles. Its 356 stores are located throughout the United States and Puerto Rico and focus on marquee allocated footwear and branded apparel. The Footaction stores have an average of 2,900 selling square feet.

Lady Foot Locker — Lady Foot Locker is a leading U.S. retailer of athletic footwear, apparel and accessories for women. Its stores carry major athletic footwear and apparel brands, as well as casual wear and an assortment of proprietary merchandise designed for a variety of activities, including running, basketball, walking, and fitness. Its 526 stores are located in the United States and Puerto Rico, and have an average of 1,300 selling square feet.

Kids Foot Locker — Kids Foot Locker is a national children's athletic retailer that offers the largest selection of brand-name athletic footwear, apparel and accessories for children. Its stores feature an environment geared to appeal to both parents and children. Its 321 stores are located in the United States and Puerto Rico and have an average of 1,400 selling square feet.

Store Profile

	At February 3, 2007	Opened	Closed	At February 2, 2008
Foot Locker	2,101	66	161	2,006
Champs Sports	576	22	22	576
Footaction	373	6	23	356
Lady Foot Locker	557	10	41	526
Kids Foot Locker	335	13	27	321
Total Athletic Stores	3,942	117	274	3,785

Direct-to-Customers

Footlocker.com Footlocker.com, Inc., sells, through its affiliates, directly to customers through catalogs and its Internet websites. Eastbay, Inc., one of its affiliates, is one of the largest direct marketers of athletic footwear, apparel, equipment, team licensed and private-label merchandise in the United States and provides the Company's eight full-service e-commerce sites access to an integrated fulfillment and distribution system. The Company has a strategic alliance to offer footwear and apparel on the Amazon.com website and the Foot Locker brands are featured in the Amazon.com specialty stores for apparel and accessories and sporting goods. In addition, the Company has a marketing agreement with the U.S. Olympic Committee (USOC) providing the Company with the exclusive rights to sell USOC licensed products through catalogs and via an e-commerce site. The Company has an agreement with ESPN for ESPN Shop an ESPN-branded direct mail catalog and e-commerce site linked to *www.ESPNshop.com*, where consumers can purchase athletic footwear, apparel and equipment which will be managed by Footlocker.com. Both the catalog and the e-commerce site feature a variety of ESPN-branded and non-ESPN-branded athletically inspired merchandise.

Franchise Operations

In March of 2006, the Company entered into a ten-year area development agreement with the Alshaya Trading Co. W.L.L., in which the Company agreed to enter into separate license agreements for the operation of a minimum of 75 Foot Locker stores, subject to certain restrictions, located within the Middle East. Additionally in March 2007, the Company entered into a ten-year agreement with another third party for the exclusive right to open and operate up to 33 Foot Locker stores in the Republic of South Korea. A total of 10 franchised stores were operational at February 2, 2008. Revenue from the 10 franchised stores was not significant for the year-ended February 2, 2008. These stores are not included in the Company's operating store count above.

Overview of Consolidated Results

The 2007 results represent the 52 weeks ended February 2, 2008 as compared with the prior year which represented the 53 weeks ended February 3, 2007. Income from continuing operations was $49 million or $0.32 per diluted share as compared with the corresponding prior-year period of $247 million or $1.58 per diluted share. Difficult industry trends as well as internal factors affected the 2007 results. Sales of low-profile and casual footwear significantly declined and sales of branded and licensed apparel were weak. Internal factors contributing to the decline included oversupplied inventory, due, in part, to the lack of a clear fashion trend in athletic footwear and apparel, which necessitated higher than normal markdowns.

The following key factors affected the Company's results in the current year and comparability with the prior year:

- Comparable-store sales declined 6.3 percent.
- Gross margin was negatively affected by higher markdowns primarily to liquidate slow-moving merchandise and lower vendor allowances.
- Included in 2007 were charges associated with the Company's store closing program and non-cash impairment charges totaling $128 million, pre-tax, or $0.52 per diluted share. Impairment charges totaling $124 million were recorded to write-down the value of long-lived assets of underperforming stores in the Company's U.S. retail store operations and for stores included in the store closing program. The Company closed 33 unproductive stores during 2007 as part of the announced store closing program. Included in 2006 was an impairment charge of $17 million, or $0.08 per diluted share, to write-down long-lived assets of the European operations.

- Included in 2007 was a Canadian income tax valuation allowance adjustment that increased net income by $65 million, or $0.42 per diluted share.

- The 53rd week of 2006 represented $95 million in sales and net income of $18 million, or $0.11 per diluted share.

Despite the difficult year experienced, the Company ended the year in a strong financial position. Key highlights of the year included:

- Cash and cash equivalents as of February 2, 2008 were $488 million, reflecting cash flow provided by operations of $283 million.
- Merchandise inventories were reduced by approximately 4 percent, excluding the effect of foreign currency fluctuations.
- Repaid $2 million of its 5-year term loan, in advance of the regularly scheduled payment date of May 2008.
- Purchased and retired $5 million of the $200 million 8.50 percent debentures payable in 2022, bringing the outstanding amount to $129 million as of February 2, 2008.
- Dividends totaling $77 million were declared and paid.
- $50 million of common stock was repurchased.

The following table represents a summary of sales and operating results, reconciled to (loss) income from continuing operations before income taxes.

	2007	2006 (in millions)	2005
Sales			
Athletic Stores	$5,071	$5,370	$5,272
Direct-to-Customers	364	380	381
Family Footwear	2		
	$5,437	$5,750	$5,653
Operating Results			
Athletic Stores	$ (27)	$ 405	$ 419
Direct-to-Customers	40	45	48
Family Footwear (1)	(6)		
Division profit	7	450	467
Restructuring income (charge)(2)	2	(1)	
Total division profit	9	449	467
Corporate expense	(59)	(68)	(58)
Total operating (loss) profit	(50)	381	409
Other income	1	14	6
Interest expense, net	1	3	10
(Loss) income from continuing operations before income taxes	$ (50)	$ 392	$ 405

(1) During the first quarter of 2007, the Company launched a new family footwear concept, Footquarters. The concepts results did not meet the Companys expectations and, therefore, the Company decided not to further invest in this business. These stores were converted to the Companys other formats. Included in the operating loss of $6 million, was approximately $2 million of costs associated with the removal of signage and the write-off of unusable fixtures.

(2) During 2007, the Company adjusted its 1993 Repositioning and 1991 Restructuring reserve by $2 million primarily due to favorable lease terminations. During 2006, the Company recorded a restructuring charge of $1 million, which represented a revision to the original estimate of the lease liability associated with the guarantee of The San Francisco Music Box Company distribution center. These amounts are included in selling, general and administrative expenses in the Consolidated Statements of Operations.

On March 11, 2008, we filed a Current Report on Form 8-K, which included a press release announcing our fourth quarter and full year 2007 financial results. In completing our final analysis, we determined that our income tax benefit was overstated by $2 million. While not material to understanding fourth quarter and full year 2007 financial results contained in the March 10, 2008, press release, the amount disclosed above has been recorded in our actual results for the fourth quarter and full year 2007. We believe noting this change is beneficial to understanding the actual results for the fourth quarter and full year 2007 contained in this financial report. Accordingly, the full year 2007 income tax benefit was reduced from $101 million reported in the press release to a benefit of $99 million. Diluted earnings per share for the full year 2007 was changed from $0.34 to $0.33.

Sales

All references to comparable-store sales for a given period relate to sales from stores that are open at the period-end, that have been open for more than one year, and exclude the effect of foreign currency fluctuations. Accordingly, stores opened and closed during the period are not included. Sales from the Direct-to-Customer segment are included in the calculation of comparable-store sales for all periods presented. Sales from acquired businesses that include the purchase of inventory are included in the computation of comparable-store sales after 15 months of operations. Accordingly, Footaction sales have been included in the computation of comparable-store sales since August 2005.

Sales decreased to $5,437 million, or by 5.4 percent as compared with 2006. Excluding the effect of foreign currency fluctuations, sales declined 7.6 percent as compared with 2006. Comparable-store sales decreased by 6.3 percent.

Sales of $5,750 million in 2006 increased by 1.7 percent from sales of $5,653 million in 2005. Excluding the effect of foreign currency fluctuations and the 53rd week, sales declined 0.7 percent as compared with 2005. Comparable-store sales decreased by 1.2 percent, which was primarily a result of the decline in the European operations.

Gross Margin

Gross margin as a percentage of sales was 26.1 percent in 2007 declining 410 basis points as compared with 2006. Gross margin, as a percentage of sales, was negatively affected by incremental markdowns of 180 basis points taken to liquidate slow-moving and excess inventory and the effect of reduced vendor allowances negatively affected gross margin by approximately 60 basis points, as compared with 2006. Lower sales resulted in the occupancy rate increasing by 160 basis points, as a percentage of sales, as compared with the prior-year period.

Gross margin as a percentage of sales was 30.2 percent in 2006; excluding the effect of the 53rd week, gross margin would have declined 20 basis points as compared with 2005. This reflected increased promotional activity, offset, in part, by the effect of increased vendor allowances. The effect of these vendor allowances was an improvement in gross margin in 2006, as a percentage of sales, of 20 basis points as compared with 2005. Additionally, gross margin was negatively affected by lower sales, which resulted in increased occupancy costs, as a percentage of sales.

Selling, General and Administrative Expenses

Selling, general and administrative (SG&A) expenses increased by $13 million to $1,176 million in 2007, or by 1.1 percent, as compared with 2006. SG&A as a percentage of sales increased to 21.6 percent as compared with 20.2 percent in 2006. The increase in SG&A as a percentage of sales is due to the decline in sales. Excluding the effect of foreign currency fluctuations and the 53rd week in 2006, SG&A decreased by $2 million. This decrease primarily reflected savings associated with operating fewer stores, as well as controlling variable expenses as compared with the prior-year period.

SG&A increased by $34 million to $1,163 million in 2006, or by 3.0 percent, as compared with 2005. SG&A as a percentage of sales increased to 20.2 percent, as compared with 20.0 percent in 2005. Excluding the effect of foreign currency fluctuations and the 53rd week, SG&A would have increased by 1.4 percent. This increase was primarily the result of incremental share-based compensation included in corporate expense, associated with the

adoption of SFAS No. 123(R) of $6 million. Additionally, the net benefit cost for the Company's pension and postretirement plans reflected a reduction of $5 million, primarily as a result of additional contributions and improved pension fund asset performance.

Corporate Expense

Corporate expense consists of unallocated general and administrative expenses as well as depreciation and amortization related to the Company's corporate headquarters, centrally managed departments, unallocated insurance and benefit programs, certain foreign exchange transaction gains and losses, and other items.

Corporate expense decreased by $9 million to $59 million in 2007 as compared with 2006. Depreciation and amortization included in corporate expense amounted to $14 million in 2007 and $22 million in 2006, the decrease reflecting certain software assets which were fully depreciated. Excluding the change in corporate expense related to depreciation and amortization, corporate expense declined primarily due to reduced incentive compensation expense.

The increase in corporate expense in 2006 as compared with 2005 of $10 million reflects the adoption of SFAS No. 123(R) that resulted in incremental compensation expense of $6 million and a charge of $4 million for anticipated settlements of certain legal matters. The effect of the 53rd week on corporate expense was not significant. Depreciation and amortization included in corporate expense amounted to $22 million in 2006 and $24 million in 2005.

Depreciation and Amortization

Depreciation and amortization of $166 million decreased by 5.1 percent in 2007 from $175 million in 2006. This decrease primarily reflects reduced software amortization of $8 million as assets became fully depreciated and reduced depreciation and amortization associated with the third quarter impairment charge of $8 million. These decreases were offset, in part, by the effect of foreign currency fluctuations, which increased depreciation and amortization expense by $3 million, and increased depreciation and amortization related to the Company's capital spending.

Depreciation and amortization of $175 million increased by 2.3 percent in 2006 from $171 million in 2005. This increase primarily reflected additional depreciation and amortization for the Athletic Stores segment due to capital spending and the effect of foreign currency fluctuations of approximately $1 million.

Interest Expense, Net

	2007	**2006**	**2005**
		(in millions)	
Interest expense	$ 21	$ 23	$ 23
Interest income	(20)	(20)	(13)
Interest expense, net	$ 1	$ 3	$ 10
Weighted-average interest rate (excluding facility fees):			
Short-term debt	%	%	%
Long-term debt	6.8%	7.8%	6.2%
Total debt	6.8%	7.8%	6.2%
Short-term debt outstanding during the year:			
High	$	$	$
Weighted-average	$	$	$

Interest expense of $21 million decreased by 8.7 percent in 2007 compared to $23 million in 2006. The reduction in interest expense primarily relates to the purchases and retirements of $5 million and $38 million in 2007 and 2006, respectively, of the Company's 8.50 percent debentures. Interest rate swap agreements did not significantly affect interest expense in 2007.

Interest income of $20 million remained unchanged from 2006. Interest income is generated through the investment of cash equivalents, short-term investments, the accretion of the Northern Group note to its face value and accrual of interest on the outstanding principal, as well as the effect of the Company's cross currency swaps. Interest income related to cash, cash equivalents and short-term investments was $16 million in 2007 and $14 million in 2006. Interest income on the Northern Group note amounted to $2 million in both 2007 and 2006. The cross currency swaps income totaled $1 million in 2007 as compared with $3 million in 2006.

Interest expense of $23 million in 2006 remained unchanged from 2005. Interest rate swap agreements did not significantly affect interest expense in 2006.

The increase in interest income of $7 million in 2006 as compared with 2005 was primarily related to increased interest income earned on cash, cash equivalents, and short-term investments. Interest income related to cash, cash equivalents and short-term investments was $14 million in 2006 and $11 million in 2005. Interest income on the Northern Group note amounted to $2 million in both 2006 and 2005. Also included in interest income is the effect of the Company's cross currency swaps, which totaled $3 million in 2006 and was not significant in 2005.

Other Income

In 2007, other income included a $1 million gain related to a final settlement with the Company's insurance carriers of a claim related to a store damaged by a fire in 2006. Additionally, the Company sold two of its lease interests in Europe for a gain of $1 million. These gains were offset primarily by premiums paid for foreign currency option contracts. The 2006 amounts included a net gain of $4 million from the termination of two of the Company's leases for approximately $5 million and insurance claims related to Hurricane Katrina that resulted in a gain of $8 million, which represented amounts in excess of losses. Also during 2006, the Company purchased and retired $38 million of long-term debt at a discount from face value of $2 million.

Income Taxes

The effective tax rate for 2007 was a benefit of 198.0 percent as compared with an expense of 36.9 percent in the prior year. The change in the rate is primarily due to the $65 million valuation allowance adjustment (net of deferred costs) relating to Canadian tax depreciation and tax loss carryforwards, the change in the mix of U.S. and international profits, and the impairment charges relating to the Company's U.S. operations.

The effective tax rate for 2006 was 36.9 percent as compared with 35.0 percent in the prior year. The increase in the rate is primarily due to the change in the mix of U.S. and international profits and the $17 million impairment charge relating to the Company's European operations, as well as a $6 million valuation allowance adjustment recorded in 2005.

Segment Information

The Company evaluates performance based on several factors, the primary financial measure of which is division profit. Division profit (loss) reflects income (loss) from continuing operations before income taxes, corporate expense, non-operating income, and net interest expense.

Athletic Stores

	2007	2006	2005
		(in millions)	
Sales	$5,071	$5,370	$5,272
Division (loss) profit	$ (27)	$ 405	$ 419
Sales as a percentage of consolidated total	93%	93%	93%
Division (loss) profit margin	(0.5)%	7.5%	7.9%
Number of stores at year end	3,785	3,942	3,921
Selling square footage (in millions)	8.50	8.74	8.71
Gross square footage (in millions)	14.12	14.55	14.48

2007 compared with 2006

Athletic Stores sales of $5,071 million decreased 5.6 percent in 2007, as compared with $5,370 million in 2006. Excluding the effect of foreign currency fluctuations, primarily related to the euro, sales from athletic store formats decreased by 7.8 percent in 2007. The decline in sales for the year ended February 2, 2008 was primarily related to the domestic operations. Sales in the U.S. were negatively affected by a continuing weakening in consumer spending, unseasonable warmer weather, and a lack of clear fashion trend in athletic footwear and apparel. Internationally, comparable-store sales declined mid-single digits. In Europe, sales of low-profile footwear styles declined, while the sales trend of higher priced technical footwear was higher than the prior year. Comparable-store sales for the Athletic Stores segment decreased by 6.6 percent in 2007.

Athletic Stores reported a loss of $27 million in 2007 as compared with a profit of $405 million in 2006. The decrease in division profit was attributable to the U.S operations. The decline in the U.S. operations was offset, in part, by increases in most international formats. Included in the Athletic Stores division results for 2007 are non-cash impairment charges of $117 million 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, consistent with the Company's recoverability of long-lived assets policy. Additionally, in 2007, the Company identified unproductive stores for closure; accordingly,

the Company evaluated the recoverability of long-lived assets considering the revised estimated future cash flows. The Company recorded an additional non-cash impairment charge of $7 million as a result of this analysis. Exit costs related to 33 stores that closed during 2007, comprising primarily lease termination costs of $4 million, were recognized in accordance with SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities."

2006 compared with 2005

Athletic Stores sales of $5,370 million increased 1.9 percent in 2006, as compared with $5,272 million in 2005. Excluding the effect of foreign currency fluctuations, primarily related to the euro, and the effect of the 53rd week, sales from athletic store formats decreased by 0.6 percent in 2006. Footaction and Champs Sports significantly increased sales, primarily from the sale of marquee basketball and running footwear. This was offset primarily by decreased sales in Foot Locker Europe. Foot Locker Europe's sales declined due to the continued difficult athletic retail environment, particularly in France, the U.K. and Italy. Comparable-store sales for the Athletic Stores segment decreased by 1.1 percent in 2006.

Division profit from Athletic Stores decreased by 3.3 percent to $405 million in 2006 from $419 million in 2005. Division profit as a percentage of sales decreased to 7.5 percent. The decrease in division profit is primarily attributable to the Foot Locker Europe division due to the fashion shift from higher priced marquee footwear to lower priced low-profile footwear styles and a highly competitive retail environment, particularly for the sale of low-profile footwear styles. Included in the Athletic Stores division profit for 2006 is an impairment charge of $17 million related to the Company's European operations, consistent with the Company's recoverability of long-lived assets policy. The charge was comprised primarily of stores located in the U.K. and France. Excluding the impairment charge, Athletic Stores division profit increased by 0.7 percent as compared with the corresponding prior-year period. The decline in Foot Locker Europe were offset by increases in all other divisions.

Direct-to-Customers

	2007	2006 (in millions)	2005
Sales	$ 364	$ 380	$ 381
Division profit	$ 40	$ 45	$ 48
Sales as a percentage of consolidated total	7%	7%	7%
Division profit margin	11.0%	11.8%	12.6%

2007 compared with 2006

Direct-to-Customers sales decreased 4.2 percent to $364 million in 2007, as compared with $380 million in 2006. Internet sales increased by 6.3 percent to $287 million, as compared with 2006. Catalog sales decreased by 30.0 percent to $77 million in 2007 from $110 million in 2006. Management believes that the decrease in catalog sales, which was substantially offset by the increase in Internet sales, is a result of customers browsing and selecting products through its catalogs and then making their purchases via the Internet. Sales were negatively affected by reduced sales from third party arrangements, as well as weakened consumer spending for athletic footwear and apparel.

The Direct-to-Customers business generated division profit of $40 million in 2007, as compared with $45 million in 2006. Division profit, as a percentage of sales, decreased to 11.0 percent in 2007 from 11.8 percent in 2006. The decline in division profit is a result of lower sales.

2006 compared with 2005

Direct-to-Customers sales decreased to $380 million in 2006, as compared with $381 million in 2005. Internet sales increased to $270 million, increasing by 11.1 percent as compared with 2005. Catalog sales decreased by 20.3 percent to $110 million in 2006 from $138 million in 2005. Management believes that the decrease in catalog sales, which was substantially offset by the increase in Internet sales, is a result of customers browsing and selecting products through its catalogs and then making their purchases via the Internet. Sales for the Direct-to-Customer business were negatively affected by the termination of a third party arrangement in the early part of 2006.

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The Direct-to-Customers business generated division profit of $45 million in 2006, as compared with $48 million in 2005. Division profit, as a percentage of sales, decreased to 11.8 percent in 2006 from 12.6 percent in 2005. Several initiatives were implemented to mitigate the loss of revenue from the cancelled third party contract, such as expanding the ESPN offerings. However, these initiatives did not fully offset the loss in profit which resulted in a decline in division profit. The effect of the 53rd week on this segment was not significant.

Liquidity and Capital Resources

Liquidity

Generally, the Company's primary source of cash has been from operations. The Company generally finances real estate with operating leases. The principal uses of cash have been to finance inventory requirements, capital expenditures related to store openings, store remodelings, and management information systems and other support facilities, and to fund general working capital requirements.

Management believes its cash, cash equivalents and future operating cash flow from operations will be adequate to fund its working capital requirements, capital expenditures, pension contributions for the Company's retirement plans, anticipated quarterly dividend payments, scheduled debt repayments, potential share repurchases, and other cash requirements to support the development of its short-term and long-term operating strategies.

Maintaining access to merchandise that the Company considers appropriate for its business may be subject to the policies and practices of its key vendors. Therefore, the Company believes that it is critical to continue to maintain satisfactory relationships with its key vendors. The Company purchased approximately 77 percent in 2007 and 78 percent in 2006 of its merchandise from its top five vendors and expects to continue to obtain a significant percentage of its athletic product from these vendors in future periods. Approximately 56 percent in 2007 and 50 percent in 2006 was purchased from one vendor — Nike, Inc.

Planned capital expenditures for 2008 are approximately $158 million, of which $135 million relates to modernizations of existing stores and new store openings, and $23 million reflects the development of information systems and other support facilities. Additionally, the Company intends to spend an additional $2 million on key money related to Europe. The Company has the ability to revise and reschedule the anticipated capital expenditure

program, should the Company's financial position require it.

Any materially adverse change in customer demand, fashion trends, competitive market forces or customer acceptance of the Company's merchandise mix and retail locations, uncertainties related to the effect of competitive products and pricing, the Company's reliance on a few key vendors for a significant portion of its merchandise purchases, and risks associated with foreign global sourcing or economic conditions worldwide could affect the ability of the Company to continue to fund its needs from business operations.

Cash Flow

Operating activities from continuing operations provided cash of $283 million in 2007 as compared with $189 million in 2006. These amounts reflect income from continuing operations adjusted for non-cash items and working capital changes. During 2007, the Company recorded non-cash impairment charges and store closing program costs of $124 million related to its domestic operations. Merchandise inventories represented a $55 million source of cash in 2007 as inventory purchases were reduced to keep inventory levels in line with sales. Additionally, the Company did not contribute to its pension plans in 2007, as no contributions were required, compared with $68 million contributed in 2006.

Operating activities from continuing operations provided cash of $189 million in 2006 as compared with $349 million in 2005. These amounts reflect income from continuing operations adjusted for non-cash items and working capital changes. During 2006, the Company recorded a non-cash impairment charge of $17 million related to the operations in Europe. The decline in operating cash flows of $160 million is primarily due to a reduction of accounts payable at year-end reflecting an acceleration of inventory receipts earlier in the fourth quarter of 2006. In addition, due to the calendar shift related to the 53rd week, approximately $47 million of the decline represents the timing of lease payments. Additionally, the Company contributed $68 million to its U.S. and Canadian qualified pension plans in 2006, as compared with contributions of $26 million in 2005.

Net cash provided by investing activities of the Company's continuing operations was $117 million in 2007 as compared with $108 million used in investing activities in 2006. During 2007, the Company liquidated most of its short-term investments, which represented auction rate securities, due to issues in the global credit and capital markets. Capital expenditures of $148 million in 2007 and $165 million in 2006 primarily related to store remodeling and new stores. During 2007, the Company received $21 million representing the maturity of an investment of $14 million and the repayment of a note of $7 million.

Net cash used in investing activities of the Company's continuing operations was $108 million in 2006 as compared with $182 million in 2005. The Company's purchase of short-term investments, net of sales, decreased by $49 million in 2006 as compared with an increase of $31 million in 2005. Capital expenditures of $165 million in 2006 and $155 million in 2005 primarily related to store remodeling and new stores. During 2006, the Company received net proceeds of $4 million as a result a lease termination. The Company also received $4 million of insurance proceeds from its insurance carriers related to the final settlement of the property and equipment claims for the 2005 hurricanes.

Net cash used in financing activities of continuing operations was $138 million in 2007 as compared with $142 million in 2006. During 2007, the Company repaid $2 million of its term loan, purchased and retired $5 million of its 8.50 percent debentures payable in 2022, and repaid and retired its $14 million Industrial Revenue Bond which was accounted for as capital lease. As required by SFAS No. 123(R), the Company recorded an excess tax benefit related to stock-based compensation of $1 million as a financing activity. The Company declared and paid dividends totaling $77 million in 2007 and $61 million in 2006. During 2007 and 2006, the Company received proceeds from the issuance of common stock and treasury stock in connection with the employee stock programs of $9 million and $12 million, respectively. During 2007, the Company purchased 2,283,254 shares of its common stock for approximately $50 million. On February 20, 2008, the Board of Directors declared a quarterly cash dividend of $0.15 per share, which will be payable on May 2, 2008 to shareholders of record on April 18, 2008. This dividend represents a 20 percent increase over the previous quarterly per share amount and is equivalent to an annualized rate of $0.60 per share.

Net cash used in financing activities of continuing operations was $142 million in 2006 as compared with $105 million in 2005. During 2006, the Company repaid $50 million of its term loan and purchased and retired $38 million of its 8.50 percent debentures payable in 2022 at a $2 million discount from face value. The Company recorded an excess tax benefit related to stock-based compensation of $2 million as a financing activity. The Company declared and paid dividends totaling $61 million in 2006 and $49 million in 2005. During 2006 and 2005, the Company received proceeds from the issuance of common stock and treasury stock in connection with the employee stock programs of $12 million and $14 million, respectively. During 2006, the Company purchased 334,200 shares of its common stock for approximately $8 million.

Capital Structure

During 2004, the Company obtained a 5-year, $175 million term loan to finance a portion of the purchase price of the Footaction stores. The Company has repaid $87 million of the term loan, in advance of the scheduled repayment dates, thereby reducing the term loan to $88 million as of February 2, 2008.

In October 2007, the Company amended its revolving credit agreement to provide for a one-year extension of the revolving credit facility to May 19, 2010 and a reduction in the fixed charge coverage ratio to no less than 1.25:1 for the fourth quarter of 2007 and the first quarter of 2008, increasing to 2.0:1 by the first quarter of 2010. The amendment also permits the payment of dividends by the Company of up to $90 million in 2008 and up to $100 million for each year thereafter. On February 19, 2008, the Company further amended its revolving credit facility to increase the amount permitted to be paid as dividends in 2008 to $95 million. With regard to stock repurchases, the amendment provides that not more than $50 million in the aggregate may be expended after October 26, 2007 unless the fixed charge coverage ratio is at least 2.0:1 for the quarter immediately preceding any such repurchase and the Company has delivered its annual audited financial statements with respect to 2007. The agreement includes various restrictive financial covenants with which the Company was in compliance on February 2, 2008.

During 2006, the Company purchased and retired $38 million of the $200 million 8.50 percent debentures payable in 2022 at a $2 million discount from face value. During 2007, the Company purchased and retired $5 million of the $200 million 8.50 percent debentures payable in 2022 bringing the outstanding amount (excluding the fair value of the interest rate swap) to $129 million as of February 2, 2008.

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Credit Rating

As of March 31, 2008, the Companys corporate credit ratings from Standard & Poors and Moodys Investors Service are BB and Ba3, respectively. Additionally, as of March 31, 2008, Moodys Investor Services has rated the Companys senior unsecured notes B1.

Debt Capitalization and Equity

For purposes of calculating debt to total capitalization, the Company includes the present value of operating lease commitments in total net debt. Total net debt including the present value of operating leases is considered a non-GAAP financial measure. The present value of operating leases is discounted using various interest rates ranging from 4 percent to 13 percent, which represent the Companys incremental borrowing rate at inception of the lease. Operating leases are the primary financing vehicle used to fund store expansion and, therefore, we believe that the inclusion of the present value of operating lease in total debt is useful to our investors, credit constituencies, and rating agencies. The following table sets forth the components of the Companys capitalization, both with and without the present value of operating leases:

	2007	2006
	(in millions)	
Long-term debt and obligations under capital lease	$ 221	$ 234
Present value of operating leases	2,126	2,069
Total debt including the present value of operating leases	2,347	2,303

Less:		
Cash and cash equivalents	488	221
Short-term investments	5	249
Total net debt including the present value of operating leases	1,854	1,833
Shareholders equity	2,271	2,295
Total capitalization	$ 4,125	$ 4,128
Total net debt capitalization percent including the present value of operating leases	44.9%	44.4%
Net debt capitalization percent	%	%

The Company reduced debt and capital lease obligations by $13 million, and increased cash, cash equivalents, and short-term investments by $23 million during 2007. Additionally, the present value of the operating leases increased by $57 million representing the net change of lease renewals and the effect of foreign currency fluctuations primarily related to the euro. Including the present value of operating leases, the Companys net debt capitalization percent increased 50 basis points in 2007. The decrease in shareholders equity of $24 million in 2007 relates to the following: net income of $51 million in 2007, $77 million in dividends paid, $21 million related to stock plans, and an increase of $60 million in the foreign exchange currency translation adjustment, primarily related to the value of the euro in relation to the U.S. dollar. Additionally, the Company repurchased 2,283,254 shares of common stock for approximately $50 million during the year. As required by SFAS No. 158, during 2007 the Company recognized, within accumulated other comprehensive loss, amortization of prior service costs and net actuarial gains and losses, as well as an additional charge representing the change in the funded status of the pension plans which totaled $29 million, after-tax.

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Contractual Obligations and Commitments

The following tables represent the scheduled maturities of the Companys contractual cash obligations and other commercial commitments as of February 2, 2008:

		Payments Due by Period			
Contractual Cash Obligations	**Total**	**Less than 1 Year**	**2 3 Years**	**3 5 Years**	**After 5 Years**
			(in millions)		
Long-term debt(1)	$ 221	$	$ 88	$	$ 133
Operating leases(2)	2,793	487	832	651	823
Other long-term liabilities(3)					
Total contractual cash obligations	$ 3,014	$ 487	$ 920	$ 651	$ 956

(1) The amounts presented above represent the contractual maturities of the Companys long-term debt, excluding interest. Additional information is included in the Long-Term Debt and Obligations under Capital Leases footnote under Item 8. Consolidated Financial Statements and Supplementary Data.

(2) The amounts presented represent the future minimum lease payments under non-cancelable operating leases. In addition to minimum rent, certain of the Companys leases require the payment of additional costs for insurance, maintenance, and other costs. These costs have historically represented approximately 25 to 30 percent of the minimum rent amount. These additional amounts are not included in the table of contractual commitments as the timing and/or amounts of such payments are unknown.

(3)

The Company's other liabilities in the Consolidated Balance Sheet as of February 2, 2008 primarily comprise pension and postretirement benefits, deferred rent liability, income taxes, workers' compensation and general liability reserves and various other accruals. These liabilities have been excluded from the above table as the timing and/or amount of any cash payment is uncertain. The timing of the remaining amounts that are known have not been included as they are minimal and not useful to the presentation. Additional information is included in the "Other Liabilities" footnote under "Item 8. Consolidated Financial Statements and Supplementary Data."

Contractual Cash Obligations	Total Amounts Committed	Amount of Commitment Expiration by Period: Less than 1 Year	2 – 3 Years	3 – 5 Years	After 5 Years
	(in millions)				
Line of credit	$ 189	$ —	$ 189	$ —	$ —
Stand-by letters of credit	11	—	11	—	—
Purchase commitments[4]	1,453	1,450	3	—	—
Other[5]	57	19	33	5	—
Total commercial commitments	$ 1,710	$ 1,469	$ 236	$ 5	$ —

(4) Represents open purchase orders, as well as minimum required purchases under merchandise contractual agreements, at February 2, 2008. The Company is obligated under the terms of purchase orders; however, the Company is generally able to renegotiate the timing and quantity of these orders with certain vendors in response to shifts in consumer preferences.

(5) Represents payments required by non-merchandise purchase agreements and minimum royalty requirements.

The Company does not have any off-balance sheet financing, other than operating leases entered into in the normal course of business as disclosed above, or unconsolidated special purpose entities. The Company does not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, including variable interest entities. The Company's policy prohibits the use of derivatives for which there is no underlying exposure.

In connection with the sale of various businesses and assets, the Company may be obligated for certain lease commitments transferred to third parties and pursuant to certain normal representations, warranties, or indemnifications entered into with the purchasers of such businesses or assets. Although the maximum potential amounts for such obligations cannot be readily determined, management believes that the resolution of such contingencies will not significantly affect the Company's consolidated financial position, liquidity, or results of operations. The Company is also operating certain stores for which lease agreements are in the process of being negotiated with landlords. Although there is no contractual commitment to make these payments, it is likely that leases will be executed.

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Critical Accounting Policies

Management's responsibility for integrity and objectivity in the preparation and presentation of the Company's financial statements requires diligent application of appropriate accounting policies. Generally, the Company's accounting policies and methods are those specifically required by U.S. generally accepted accounting principles ("GAAP"). Included in the "Summary of Significant Accounting Policies" footnote in "Item 8. Consolidated Financial Statements and Supplementary Data" is a summary of the Company's most significant accounting policies. In some cases, management is required to calculate amounts based on estimates for matters that are inherently uncertain. The Company believes the following to be the most critical of those accounting policies that necessitate subjective judgments.

Merchandise Inventories

Merchandise inventories for the Company's Athletic Stores are valued at the lower of cost or market using the retail inventory method. The retail inventory method ("RIM") is commonly used by retail companies to value inventories at cost and calculate gross margins due to its practicality. Under the retail method, cost is determined by applying a cost-to-retail percentage across groupings of similar items, known as departments. The cost-to-retail percentage is applied to ending inventory at its current owned retail valuation to determine the cost of ending inventory on a department basis. The RIM is a system of averages that requires management's estimates and assumptions regarding markups, markdowns and shrink, among others, and as such, could result in distortions of inventory amounts. Significant judgment is required for these estimates and assumptions, as well as to differentiate between promotional and other markdowns that may be required to correctly reflect merchandise inventories at the lower of cost or market. The Company provides reserves based on current selling prices when the inventory has not been marked down to market. The failure to take permanent markdowns on a timely basis may result in an overstatement of cost under the retail inventory method. The decision to take permanent markdowns includes many factors, including the current environment, inventory levels and the age of the item. Management believes this method and its related assumptions, which have been consistently applied, to be reasonable.

Vendor Reimbursements

In the normal course of business, the Company receives allowances from its vendors for markdowns taken. Vendor allowances are recognized as a reduction in cost of sales in the period in which the markdowns are taken. The effect of vendor allowances negatively effected gross margin in 2007, as a percentage of sales, of 60 basis points as compared with 2006. The Company also has volume-related agreements with certain vendors, under which it receives rebates based on fixed percentages of cost purchases. These volume-related rebates are recorded in cost of sales when the product is sold and they contributed 10 basis points to the 2007 gross margin rate.

The Company receives support from some of its vendors in the form of reimbursements for cooperative advertising and catalog costs for the launch and promotion of certain products. The reimbursements are agreed upon with vendors for specific advertising campaigns and catalogs. Cooperative income, to the extent that it reimburses specific, incremental and identifiable costs incurred to date, is recorded in SG&A in the same period as the associated expenses are incurred. Reimbursements received that are in excess of specific, incremental and identifiable costs incurred to date are recognized as a reduction to the cost of merchandise and are reflected in cost of sales as the merchandise is sold. Cooperative reimbursements amounted to approximately 33 percent of total advertising costs in 2007 and approximately 11 percent of catalog costs in 2007.

Impairment of Long-Lived Assets

In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"), the Company recognizes an impairment loss when circumstances indicate that the carrying value 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. If an analysis is necessitated by the occurrence of a triggering event, the Company uses assumptions, which are predominately identified from the Company's three-year strategic plans, in determining the impairment amount. The calculation of fair value of long-lived assets is based on estimated expected discounted

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future cash flows by store, which is generally measured by discounting the expected future cash flows at the Company's weighted-average cost of capital. Management believes its policy is reasonable and is consistently applied. Future expected cash flows are based upon estimates that, if not achieved, may result in significantly different results.

During 2007, the Company recorded non-cash impairment charges totaling $124 million primarily to write-down long-lived assets such as store fixtures and leasehold improvements for the Company's U.S. store operations pursuant to SFAS No. 144.

The Company is required to perform an impairment review of its goodwill at least annually. The Company has chosen to perform this review at the beginning of each fiscal year, and it is done in a two-step approach. The initial

step requires that the carrying value of each reporting unit be compared with its estimated fair value. The second step to evaluate goodwill of a reporting unit for impairment is only required if the carrying value of that reporting unit exceeds its estimated fair value.

The fair value of each of the Companys reporting units exceeded its carrying value as of the beginning of the year. The Company used a combination of a discounted cash flow approach and market-based approach to determine the fair value of a reporting unit. The latter requires judgment and uses one or more methods to compare the reporting unit with similar businesses, business ownership interests or securities that have been sold.

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.

Share-Based Compensation

The Company estimates the fair value of options granted using the Black-Scholes option pricing model. The Company estimates the expected term of options granted using its historical exercise and post-vesting employment termination patterns, which the Company believes are representative of future behavior. Changing the expected term by one year changes the fair value by 10 to 15 percent depending if the change was an increase or decrease to the expected term. The Company estimates the expected volatility of its common stock at the grant date using a weighted-average of the Companys historical volatility and implied volatility from traded options on the Companys common stock. A 50 basis point change in volatility would have a 1 percent change to the fair value. The risk-free interest rate assumption is determined using the Federal Reserve nominal rates for U.S. Treasury zero-coupon bonds with maturities similar to those of the expected term of the award being valued. The expected dividend yield is derived from the Companys historical experience. A 50 basis point change to the dividend yield would change the fair value by approximately 5 percent. The Company records stock-based compensation expense only for those awards expected to vest using an estimated forfeiture rate based on its historical pre-vesting forfeiture data, which it believes are representative of future behavior, and periodically will revise those estimates in subsequent periods if actual forfeitures differ from those estimates.

The Black-Scholes option valuation model requires the use of subjective assumptions. Changes in these assumptions can materially affect the fair value of the options. The Company may elect to use different assumptions under the Black-Scholes option pricing model in the future if there is a difference between the assumptions used in determining stock-based compensation cost and the actual factors that become known over time.

Pension and Postretirement Liabilities

The Company determines its obligations for pension and postretirement liabilities based upon assumptions related to discount rates, expected long-term rates of return on invested plan assets, salary increases, age, and mortality among others. Management reviews all assumptions annually with its independent actuaries, taking into consideration existing and future economic conditions and the Companys intentions with regard to the plans. Management believes that its estimates for 2007, as disclosed in Item 8. Consolidated Financial Statements and Supplementary Data, to be reasonable.

Long-Term Rate of Return Assumption - The expected long-term rate of return on invested pension plan assets is a component of pension expense. The rate is based on the plans weighted-average target asset allocation, as well as historical and future expected performance of those assets. The target asset allocation is selected to obtain an investment return that is sufficient to cover the expected benefit payments and to reduce future contributions by the Company. The Companys common stock represented approximately 1 percent of the total pension plans assets at February 2, 2008.

The weighted-average long-term rate of return used to determine 2007 pension expense was 8.85 percent. A decrease of 50 basis points in the weighted-average expected long-term rate of return would have increased 2007 pension expense by approximately $3 million. The actual return on plan assets in a given year may differ from the expected long-term rate of return and the resulting gain or loss is deferred and amortized into the plans expense

over time.

Discount Rate - An assumed discount rate is used to measure the present value of future cash flow obligations of the plans and the interest cost component of pension expense and postretirement income. The discount rate selected to measure the present value of the Company's U.S. benefit obligations as of February 2, 2008 was derived using a cash flow matching method whereby the Company compares the plans' projected payment obligations by year with the corresponding yield on the Citibank Pension Discount Curve. The cash flows are then discounted to their present value and an overall discount rate is determined. The discount rate selected to measure the present value of the Company's Canadian benefit obligations as of February 2, 2008 was developed by using the plan's bond portfolio indices which match the benefit obligations.

A decrease of 50 basis points in the weighted-average discount rate would have increased the accumulated benefit obligation as of February 2, 2008 of the pension plans by approximately $27 million and the effect on the postretirement plan would not be significant. Such a decrease would not have significantly changed 2007 pension expense or postretirement income.

There is limited risk to the Company for increases in health care costs related to the postretirement plan as, beginning in 2001, new retirees have assumed the full expected costs and then-existing retirees and future retirees have assumed all increases in such costs.

The Company expects to record postretirement income of approximately $8 million and pension expense of approximately $5 million in 2008.

Income Taxes

In accordance with GAAP, deferred tax assets are recognized for tax credit and net operating loss carryforwards, reduced by a valuation allowance, which is established when it is more likely than not that some portion or all of the deferred tax assets will not be realized. Management is required to estimate taxable income for future years by taxing jurisdiction and to use its judgment to determine whether or not to record a valuation allowance for part or all of a deferred tax asset. A one percent change in the Company's overall statutory tax rate for 2007 would have resulted in a $8 million change in the carrying value of the net deferred tax asset and a corresponding charge or credit to income tax expense depending on whether such tax rate change was a decrease or increase.

The Company has operations in multiple taxing jurisdictions and is subject to audit in these jurisdictions. Tax audits by their nature are often complex and can require several years to resolve. Accruals of tax contingencies require management to make estimates and judgments with respect to the ultimate outcome of tax audits. Actual results could vary from these estimates.

The Company expects its 2008 effective tax rate to be approximately 35.5 percent. The actual rate will primarily depend upon the percentage of the Company's income earned in the United States as compared with international operations.

Discontinued, Repositioning and Restructuring Reserves

The Company exited four business segments as part of its discontinuation and restructuring programs. The final discontinued segment and disposition of the restructured businesses were completed in 2001. In order to identify and calculate the associated costs to exit these businesses, management made assumptions regarding estimates of future liabilities for operating leases and other contractual agreements, the net realizable value of assets held for sale or disposal and the fair value of non-cash consideration received. The Company has settled the majority of these liabilities and the remaining activity relates to the disposition of the residual lease liabilities.

As a result of achieving divestiture accounting in the fourth quarter of 2002, the Northern Group note was recorded at its fair value. The Company is required to review the collectibility of the note based upon various criteria such as the credit-worthiness of the issuer or a delay in payment of the principal or interest. Future adjustments, if any, to the carrying value of the note will be recorded pursuant to SEC Staff Accounting Bulletin Topic 5:Z:5, "Accounting

and Disclosure Regarding Discontinued Operations, which requires changes in the carrying value of assets received as consideration from the disposal of a discontinued operation to be classified within continuing operations. The purchaser has made all payments required under the terms of the note; however, the business has sustained unexpected operating losses during the past fiscal year. The Company has evaluated the projected performance of the business and will continue to monitor its results during the coming year. At February 2, 2008, CAD$15.5 million remains outstanding on the note, the fair value of which is US$14 million.

The remaining discontinued reserve balances at February 2, 2008 totaled $23 million of which $14 million is expected to be utilized within the next twelve months. The remaining repositioning and restructuring reserves totaled $2 million at February 2, 2008.

Disclosure Regarding Forward-Looking Statements

This report contains forward-looking statements within the meaning of the federal securities laws. All statements, other than statements of historical facts, which address activities, events or developments that the Company expects or anticipates will or may occur in the future, including, but not limited to, such things as future capital expenditures, expansion, strategic plans, dividend payments, stock repurchases, growth of the Company's business and operations, including future cash flows, revenues and earnings, and other such matters are forward-looking statements. These forward-looking statements are based on many assumptions and factors detailed in the Company's filings with the Securities and Exchange Commission, including the effects of currency fluctuations, customer demand, fashion trends, competitive market forces, uncertainties related to the effect of competitive products and pricing, customer acceptance of the Company's merchandise mix and retail locations, the Company's reliance on a few key vendors for a majority of its merchandise purchases (including a significant portion from one key vendor), unseasonable weather, economic conditions worldwide, any changes in business, political and economic conditions due to the threat of future terrorist activities in the United States or in other parts of the world and related U.S. military action overseas, the ability of the Company to execute its business plans effectively with regard to each of its business units, risks associated with foreign global sourcing, including political instability, changes in import regulations, and disruptions to transportation services and distribution. Any changes in such assumptions or factors could produce significantly different results. The Company undertakes no obligation to update forward-looking statements, whether as a result of new information, future events, or otherwise.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Information regarding interest rate risk management and foreign exchange risk management is included in the "Financial Instruments and Risk Management" footnote under "Item 8. Consolidated Financial Statements and Supplementary Data."

Item 8. Consolidated Financial Statements and Supplementary Data

MANAGEMENT'S REPORT

The integrity and objectivity of the financial statements and other financial information presented in this annual report are the responsibility of the management of the Company. The financial statements have been prepared in conformity with U.S. generally accepted accounting principles and include, when necessary, amounts based on the best estimates and judgments of management.

The Company maintains a system of internal controls designed to provide reasonable assurance, at appropriate cost, that assets are safeguarded, transactions are executed in accordance with management's authorization and the accounting records provide a reliable basis for the preparation of the financial statements. The system of internal accounting controls is continually reviewed by management and improved and modified as necessary in response to changing business conditions. The Company also maintains an internal audit function to assist management in evaluating and formally reporting on the adequacy and effectiveness of internal accounting controls, policies and procedures.

The Companys financial statements have been audited by KPMG LLP, the Companys independent registered public accounting firm, whose report expresses their opinion with respect to the fairness of the presentation of these financial statements.

The Audit Committee of the Board of Directors, which comprises solely independent non-management directors who are not officers or employees of the Company, meets regularly with the Companys management, internal auditors, legal counsel and KPMG LLP to review the activities of each group and to satisfy itself that each is properly discharging its responsibility. In addition, the Audit Committee meets on a periodic basis with KPMG LLP, without managements presence, to discuss the audit of the financial statements as well as other auditing and financial reporting matters. The Companys internal auditors and independent registered public accounting firm have direct access to the Audit Committee.

MATTHEW D. SERRA, Chairman of the Board, President and Chief Executive Officer	ROBERT W. MCHUGH, Senior Vice President and Chief Financial Officer

March 31, 2008

MANAGEMENTS REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. The Companys internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. The Companys internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Companys assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Management assessed the effectiveness of the Companys internal control over financial reporting as of February 2, 2008. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on our assessment and those criteria, management believes that the Company maintained effective internal control over financial reporting as of February 2, 2008.

MATTHEW D. SERRA, Chairman of the Board, President and Chief Executive Officer	ROBERT W. MCHUGH, Senior Vice President and Chief Financial Officer

March 31, 2008

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders of
Foot Locker, Inc.:

We have audited the accompanying consolidated balance sheets of Foot Locker, Inc. and subsidiaries as of February 2, 2008 and February 3, 2007, and the related consolidated statements of operations, comprehensive income, shareholders’ equity, and cash flows for each of the years in the three-year period ended February 2, 2008. These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Foot Locker, Inc. and subsidiaries as of February 2, 2008 and February 3, 2007, and the results of their operations and their cash flows for each of the years in the three-year period ended February 2, 2008 in conformity with U.S. generally accepted accounting principles.

As discussed in the Notes to Consolidated Financial Statements, effective February 4, 2007, the Company adopted Statement of Financial Accounting Standards Interpretation (“FIN”) No. 48, “Accounting for Uncertainty in Income Taxes.” Effective February 3, 2007, the Company adopted Statement of Financial Accounting Standards (“SFAS”) No 158, “Employers’ Accounting for Defined Benefit Pension and Other Post Retirement Plans — An Amendment of FASB Statements No. 87, 88, 106, and 132(R).” In addition, effective January 29, 2006, the Company adopted SFAS No. 123(R), “Share-Based Payment,” and SFAS No. 151, “Inventory Costs — An Amendment of ARB No. 43, Chapter 4,” as well as changed their method for quantifying errors based on SEC Staff Accounting Bulletin No. 108, “Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements.”

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Foot Locker, Inc.’s internal control over financial reporting as of February 2, 2008, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 31, 2008 expressed an unqualified opinion on the effectiveness of internal control over financial reporting.

New York, New York
March 31, 2008

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The Board of Directors and Shareholders of
Foot Locker, Inc.:

We have audited Foot Locker, Inc.’s internal control over financial reporting as of February 2, 2008, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Foot Locker, Inc.’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit

included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

In our opinion, Foot Locker, Inc. maintained, in all material respects, effective internal control over financial reporting as of February 2, 2008, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Foot Locker, Inc. and subsidiaries as of February 2, 2008 and February 3, 2007, and the related consolidated statements of operations, comprehensive income, shareholders' equity, and cash flows for each of the years in the three-year period ended February 2, 2008, and our report dated March 31, 2008 expressed an unqualified opinion on those consolidated financial statements.

New York, New York
March 31, 2008

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
	5,488	5,372	5,254
Other income	(1)	(14)	(6)
	5,487	5,358	5,248
(Loss) Income from continuing operations before income taxes	(50)	392	405
Income tax (benefit) expense	(99)	145	142
Income from continuing operations	49	247	263

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	$ 51	$ 251	$ 264
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	$ 0.33	$ 1.62	$ 1.71
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	$ 0.33	$ 1.60	$ 1.68

See Accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	2007	2006	2005
		(in millions)	
Net income	$ 51	$ 251	$ 264
Other comprehensive income, net of tax			
Foreign currency translation adjustment:			
Translation adjustment arising during the period, net of tax	60	27	(25)
Cash flow hedges:			
Change in fair value of derivatives, net of income tax	1	—	2
Reclassification adjustments, net of income tax	—	—	(1)
Net change in cash flow hedges:	1	—	1
Minimum pension liability adjustment:			
Minimum pension liability adjustment, net of deferred tax expense of $-, $120 and $10 million, respectively	—	181	15
Pension and postretirement plan adjustments, net of income tax benefit of $11 million	(20)	—	—
Unrealized loss on available-for-sale securities	(2)	—	—
Comprehensive income	$ 90	$ 459	$ 255

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
	2,064	2,034
Property and equipment, net	521	654
Deferred taxes	243	109
Goodwill	266	264
Intangible assets, net	96	105
Other assets	58	83
	$ 3,248	$ 3,249
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
	501	516
Long-term debt and obligations under capital leases	221	220
Other liabilities	255	218
Total liabilities	977	954
Shareholders' equity	2,271	2,295
	$ 3,248	$ 3,249

See Accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	2007		2006		2005	
	Shares	Amount	Shares	Amount	Shares	Amount
	(shares in thousands, amounts in millions)					
Common Stock and Paid-In Capital						
Par value $0.01 per share, 500 million shares authorized						
Issued at beginning of year	157,810	$ 653	157,280	$ 635	156,155	$ 608

Restricted stock issued under stock option and award plans	513	—	—	(3)	225	—
Forfeitures of restricted stock	—	—	—	—	—	2
Share-based compensation expense	—	10	—	10	—	6
Issued under director and employee stock plans, net of tax	674	13	530	11	900	19
Issued at end of year	158,997	676	157,810	653	157,280	635
Common stock in treasury at beginning of year	(2,107)	(47)	(1,776)	(38)	(64)	(2)
Reissued under employee stock plans	—	—	122	3	90	2
Restricted stock issued under stock option and award plans	—	—	157	3	—	—
Forfeitures/cancellations of restricted stock	(25)	—	(30)	(1)	(135)	(2)
Shares of common stock used to satisfy tax withholding obligations	(95)	(2)	(241)	(6)	(49)	(1)
Stock repurchases	(2,283)	(50)	(334)	(8)	(1,590)	(35)
Exchange of options	(13)	—	(5)	—	(28)	—
Common stock in treasury at end of year	(4,523)	(99)	(2,107)	(47)	(1,776)	(38)
	154,474	577	155,703	606	155,504	597
Retained Earnings						
Balance at beginning of year		1,785		1,601		1,386
Cumulative effect of adjustments resulting from the adoption of SAB 108, net of tax (see note 3)		—		(6)		—
Cumulative effect of adjustments resulting from the adoption of FIN 48, net of tax (see note 1)		1		—		—
Adjusted balance at beginning of year		1,786		1,595		1,386
Net income		51		251		264
Cash dividends declared on common stock $0.50, $0.40 and $0.32 per share, respectively		(77)		(61)		(49)
Balance at end of year		1,760		1,785		1,601
Accumulated Other Comprehensive Loss						
Foreign Currency Translation Adjustment						
Balance at beginning of year		37		10		35
Translation adjustment arising during the period, net of tax		60		27		(25)
Balance at end of year		97		37		10
Cash Flow Hedges						
Balance at beginning of year		—		—		(1)
Change during year, net of tax		1		—		1
Balance at end of year		1		—		—
Minimum Pension Liability Adjustment						
Balance at beginning of year		—		(181)		(196)
Change during year, net of tax		—		181		15
Balance at end of year		—		—		(181)
Pension Adjustments						
Balance at beginning of year		(133)		—		—
Adoption of SFAS No. 158		—		(133)		—
Change during year, net of tax		(29)		—		—
Balance at end of year		(162)		(133)		—
Unrealized loss on available-for-sale securities		(2)		—		—
Total Accumulated Other Comprehensive Loss		(66)		(96)		(171)
Total Shareholders’ Equity		$ 2,271		$ 2,295		$ 2,027

See Accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	2007	2006 (in millions)	2005
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	283	189	349
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	117	(108)	(182)
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	(138)	(142)	(105)
Net Cash Used In operating activities of Discontinued Operations	—	(8)	—
Effect of Exchange Rate Fluctuations on Cash and Cash Equivalents	5	1	2
Net Change in Cash and Cash Equivalents	267	(68)	64
Cash and Cash Equivalents at Beginning of Year	221	289	225
Cash and Cash Equivalents at End of Year	$ 488	$ 221	$ 289
Cash Paid During the Year:			
Interest	$ 18	$ 20	$ 21
Income taxes	$ 52	$ 133	$ 93

See Accompanying Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements include the accounts of Foot Locker, Inc. and its domestic and international subsidiaries (the Company), all of which are wholly owned. All significant intercompany amounts have been eliminated. The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

Reporting Year

The reporting period for the Company is the Saturday closest to the last day in January. Fiscal year 2007 represents the 52 weeks ending February 2, 2008. Fiscal year 2006 represented the 53 weeks ended February 3, 2007. Fiscal year 2005 represented the 52 weeks ended January 28, 2006. References to years in this annual report relate to fiscal years rather than calendar years.

Revenue Recognition

Revenue from retail stores is recognized at the point of sale when the product is delivered to customers. Internet and catalog sales revenue is recognized upon estimated receipt by the customer. Sales include shipping and handling fees for all periods presented. Sales include merchandise, net of returns and exclude all taxes as permitted by EITF Issue No. 06-3, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That is, Gross versus Net Presentation). The Company provides for estimated returns based on return history and sales levels. The Company recognizes revenue, including gift card sales and layaway sales, in accordance with SEC Staff Accounting Bulletin (SAB) No. 101, Revenue Recognition in Financial Statements, as amended by SAB No. 104, Revenue Recognition. Revenue from layaway sales is recognized when the customer receives the product, rather than when the initial deposit is paid.

Gift Cards

The Company sells gift cards to its customers; the cards do not have expiration dates. Revenue from gift card sales is recorded when the gift cards are redeemed or when the likelihood of the gift card being redeemed by the customer is remote and there is no legal obligation to remit the value of unredeemed gift cards to the relevant jurisdictions. The Company has determined its gift card breakage rate based upon historical redemption patterns. Historical experience indicates, that after 12 months, the likelihood of redemption is deemed to be remote. Gift card breakage income is included in selling, general and administrative expenses and totaled $4 million in 2007, $7 million in 2006, and $2 million in 2005. Unredeemed gift cards are recorded as a current liability.

Statement of Cash Flows

The Company has selected to present the operations of the discontinued business as one line in the Consolidated Statements of Cash Flows. For all the periods presented this caption includes only operating activities.

Store Pre-Opening and Closing Costs

Store pre-opening costs are charged to expense as incurred. In the event a store is closed before its lease has expired, the estimated post-closing lease exit costs, less the sublease rental income, is provided for once the store ceases to be used, in accordance with SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities.

Advertising Costs and Sales Promotion

Advertising and sales promotion costs are expensed at the time the advertising or promotion takes place, net of reimbursements for cooperative advertising. Cooperative advertising reimbursements earned for the launch and promotion of certain products is agreed upon with vendors and is recorded in the same period as the associated expense

is incurred. In accordance with EITF Issue No. 02-16, Accounting by a Reseller for Cash Consideration from a Vendor, the Company accounts for reimbursements received in excess of expenses incurred related to specific, incremental advertising, as a reduction to the cost of merchandise and is reflected in cost of sales as the merchandise is sold.

Advertising costs, which are included as a component of selling, general and administrative expenses, net of reimbursements for cooperative advertising, were as follows:

	2007	2006	2005
		(in millions)	
Advertising expenses	$ 105.9	$ 92.5	$ 99.0
Cooperative advertising reimbursements	(34.8)	(23.0)	(21.2)
Net advertising expense	$ 71.1	$ 69.5	$ 77.8

Catalog Costs

Catalog costs, which primarily comprise paper, printing, and postage, are capitalized and amortized over the expected customer response period to each catalog, which is generally 90 days. Cooperative reimbursements earned for the promotion of certain products is agreed upon with vendors and is recorded in the same period as the associated catalog expenses are amortized. Prepaid catalog costs totaled $4.0 million and $3.9 million at February 2, 2008 and February 3, 2007, respectively.

Catalog costs, which are included as a component of selling, general and administrative expenses, net of reimbursements for cooperative reimbursements, were as follows:

	2007	2006	2005
		(in millions)	
Catalog costs	$ 45.6	$ 47.0	$ 48.2
Cooperative reimbursements	(3.8)	(3.5)	(3.0)
Net catalog expense	$ 41.8	$ 43.5	$ 45.2

Earnings Per Share

Basic earnings per share is computed using the weighted-average number of common shares outstanding for the period. Diluted earnings per share uses the weighted-average number of common shares outstanding during the period plus dilutive common stock equivalents, such as stock options and awards. The computation of earnings per share is as follows:

	2007	2006	2005
		(in millions)	
Net income from continuing operations	$ 49	$ 247	$ 263
Weighted-average common shares outstanding	154.0	155.0	155.1
Effect of Dilution:			
Stock options and awards	1.6	1.8	2.5

Weighted-average common shares outstanding assuming dilution	155.6	156.8	157.6

Options to purchase 3.4 million, 2.8 million, and 2.2 million shares of common stock as of February 2, 2008, February 3, 2007, and January 28, 2006, respectively, were not included in the computations because the exercise price of the options was greater than the average market price of the common shares and, therefore, the effect of their inclusion would be antidilutive.

Share-Based Compensation

Effective January 29, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123(R), Share-Based Payment, and related interpretations, (SFAS No. 123(R)) to account for stock-based compensation using the modified prospective transition method and, therefore, the Company did not restate its prior period results. SFAS No. 123(R) supersedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, (APB No. 25), and revises guidance in SFAS No. 123, Accounting for Stock-Based Compensation (SFAS No. 123). Among other things, SFAS No. 123(R) requires that compensation expense be recognized in the financial statements for share-based awards based on the grant date fair value of those awards. The modified prospective transition method applies to unvested stock options, restricted shares and stock appreciation rights and issuances under the employee stock purchase plan outstanding as of January 29, 2006 based on the grant-date fair value estimated in accordance with the pro forma provisions of SFAS No. 123, and any new share-based awards granted subsequent to January 29, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). Additionally, stock-based compensation expense includes an estimate for pre-vesting forfeitures and is recognized over the requisite service periods of the awards.

Prior to January 29, 2006, the Company accounted for these stock-based compensation plans in accordance with APB No. 25 and related interpretations. This method did not result in compensation cost for stock options and shares purchased under employee stock purchase plans. No compensation expense for employee stock options was recorded, as all stock options granted under the stock option plans had an exercise price that was not less than the quoted market price at the date of grant. Compensation expense was also not recorded for employee purchases of stock under the employee stock purchase plans as it was considered non-compensatory under APB No. 25. Prior to the Companys adoption of SFAS No. 123(R), as required under the disclosure provisions of SFAS No. 123, as amended, the Company provided pro forma net income and earnings per common share for each period as if it had applied the fair value method to measure stock-based compensation expense.

During 2006, the Company recorded a cumulative effect of a change in accounting of $1 million to reflect estimated forfeitures for prior periods related to the Companys nonvested restricted stock awards. Prior to the adoption of SFAS No. 123(R), the Company recognized compensation cost of restricted stock awards over the vesting term based upon the fair value of the Companys common stock at the date of grant. Forfeitures were recorded as they occurred, however under SFAS No. 123(R) an estimate of forfeitures is required to be included over the vesting term. Under SFAS No. 123(R), the Company will continue to recognize compensation expense over the vesting term, net of estimated forfeitures. See Note 23 for information on the assumptions the Company used to calculate the fair value of stock-based compensation.

SFAS No. 123(R) requires the benefits associated with tax deductions in excess of recognized compensation cost to be reported as a financing cash flow rather than as an operating cash flow as previously required. For 2007 and 2006, the Company recorded an excess tax benefit of $1 million and $2 million, respectively, as a financing cash flow as required by the standard.

Upon exercise of stock options, issuance of restricted stock or issuance of shares under the employee stock purchase plan, the Company will issue authorized but unissued common stock or use common stock held in treasury. The Company may make repurchases of its common stock from time to time, subject to legal and contractual restrictions, market conditions and other factors.

The following table illustrates the effect on net income and earnings per common share as if the Company had applied the fair value method to measure stock-based compensation, as required under the disclosure provisions of SFAS No. 123:

	2005
Net income:	
As reported	$ 264
Compensation expense included in reported net income, net of income tax benefit	4
Total compensation expense under fair value method for all awards, net of income tax benefit	(9)
Pro forma	$ 259
Basic earnings per share:	
As reported	$ 1.71
Pro forma	$ 1.67
Diluted earnings per share:	
As reported	$ 1.68
Pro forma	$ 1.64

Cash and Cash Equivalents

The Company considers all highly liquid investments with original maturities of three months or less, including commercial paper and money market funds, to be cash equivalents. Amounts due from third party credit card processors for the settlement of debit and credit cards transactions are included as cash equivalents as they are generally collected within three business days. Cash equivalents at February 2, 2008 and February 3, 2007 were $472 million and $208 million, respectively.

Short-Term Investments

The Company accounts for its short-term investments in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities. At February 2, 2008, the Companys auction rate security was classified as available-for-sale, and accordingly is reported at fair value. Auction rate securities are perpetual preferred or long-dated securities whose dividend/coupon resets periodically through a Dutch auction process. A Dutch auction is a competitive bidding process designed to determine a rate for the next term. As of February 2, 2008, the carrying value of the Companys short-term investment of $7 million was reduced by $2 million. The unrealized loss of $2 million was recorded to accumulated comprehensive loss without tax benefit. There were no unrealized gains or losses recognized in 2006 and 2005. Realized losses recognized in 2007 were not significant.

Merchandise Inventories and Cost of Sales

Merchandise inventories for the Companys Athletic Stores are valued at the lower of cost or market using the retail inventory method. Cost for retail stores is determined on the last-in, first-out (LIFO) basis for domestic inventories and on the first-in, first-out (FIFO) basis for international inventories. The retail inventory method is commonly used by retail companies to value inventories at cost and calculate gross margins due to its practicality. Under the retail method, cost is determined by applying a cost-to-retail percentage across groupings of similar items, known as departments. The cost-to-retail percentage is applied to ending inventory at its current owned retail valuation to determine the cost of ending inventory on a department basis. The Company provides reserves based on current selling prices when the inventory has not been marked down to market. Merchandise inventories of the Direct-to-Customers business are valued at the lower of cost or market using weighted-average cost, which approximates FIFO. Transportation, distribution center and sourcing costs are capitalized in merchandise inventories. In 2006, the Company adopted SFAS No. 151, Inventory Costs- An Amendment of ARB 43, Chapter 4. This standard amends the guidance to clarify that abnormal amount of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges. With the adoption of this standard the Company no longer capitalized the freight associated with transfers between its store locations. The Company maintains an accrual for shrinkage based on historical rates.

Cost of sales is comprised of the cost of merchandise, occupancy, buyers compensation and shipping and handling costs. The cost of merchandise is recorded net of amounts received from vendors for damaged product returns, markdown allowances and volume rebates, as well as cooperative advertising reimbursements received in excess of specific, incremental advertising expenses. Occupancy reflects the amortization of amounts received from landlords for tenant improvements.

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. Managements 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 Companys 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 Companys 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.

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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 Companys hedges of net investments in various foreign subsidiaries is computed using the spot method.

Fair Value of Financial Instruments

The fair value of financial instruments is determined by reference to various market data and other valuation techniques as appropriate. The carrying value of cash and cash equivalents, and other current receivables and payables approximates fair value due to the short-term nature of these assets and liabilities. Quoted market prices of the same or similar instruments are used to determine fair value of long-term debt and forward foreign exchange contracts. Discounted cash flows are used to determine the fair value of long-term investments and notes receivable if quoted market prices on these instruments are unavailable.

Income Taxes

On February 4, 2007, the Company adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). Interpretation No. 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprises financial statements in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement standard for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Upon the adoption of FIN 48, the Company recognized a $1 million increase to retained earnings to reflect the change of its liability for the unrecognized income tax benefits as required. At February 4, 2007, the total amount of gross unrecognized tax benefits was $33 million. The Company recognizes interest and penalties related to unrecognized tax benefits in income tax expense.

The Company determines its deferred tax provision under the liability method, whereby deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts using presently enacted tax rates. Deferred tax assets are recognized for tax credits and net operating loss carryforwards, reduced by a valuation allowance, which is established when it is more likely than not that some portion or all of the deferred tax assets will not be realized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

A taxing authority may challenge positions that the Company adopted in its income tax filings. Accordingly, the Company may apply different tax treatments for transactions in filing its income tax returns than for income tax financial reporting. The Company regularly assesses its tax position for such transactions and records reserves for those differences when considered necessary.

Provision for U.S. income taxes on undistributed earnings of foreign subsidiaries is made only on those amounts in excess of the funds considered to be permanently reinvested.

Pension and Postretirement Obligations

The discount rate selected to measure the present value of the Companys U.S. benefit obligations as of February 2, 2008 was derived using a cash flow matching method whereby the Company compares the plans projected payment obligations by year with the corresponding yield on the Citibank Pension Discount Curve. The cash flows are then discounted to their present value and an overall discount rate is determined. The discount rate selected to measure the present value of the Companys Canadian benefit obligations as of February 2, 2008 was developed by using the plans bond portfolio indices which match the benefit obligations.

Insurance Liabilities

The Company is primarily self-insured for health care, workers’ compensation and general liability costs. Accordingly, provisions are made for the Company’s actuarially determined estimates of discounted future claim costs for such risks for the aggregate of claims reported and claims incurred but not yet reported. Self-insured liabilities totaled $17 million and $16 million at February 2, 2008 and February 3, 2007. The Company discounts its workers’ compensation and general liability using a risk-free interest rate. Imputed interest expense related to these liabilities was $1 million in each of 2007, 2006 and 2005.

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.

Additionally, in the third quarter of 2007, the Company identified 66 unproductive stores for closure. Accordingly, the Company evaluated the recoverability of long-lived assets considering the revised estimated future cash flows. The Company recorded an additional non-cash impairment charge of $7 million as a result of this analysis. Of the total stores identified for closure in the third quarter of 2007, 13 will remain in operation as the Company was able to negotiate more favorable lease terms. Exit costs related to 33 stores which closed during 2007, comprising primarily lease termination costs of $4 million, were recognized in accordance with SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." During 2008, the Company currently expects to close the remaining 20 unproductive stores prior to normal lease expiration, depending on the Company's success in negotiating agreements with its landlords. The lease exit costs associated with these remaining closures is expected to total $5 million to $10 million. These charges will be recorded during 2008 in accordance with SFAS No. 146. The cash impact of the 2008 store closings is expected to be minimal, as the related cash lease costs are expected to be offset by associated inventory reductions. Under SFAS No. 144, store closings may constitute discontinued operations if migration of customers and cash flows are not expected. The Company has concluded that no store closings have met the criteria for discontinued operations treatment.

Included in the Athletic Stores division profit for 2006 is an impairment charge of $17 million related to the Company's European operations to write-down long-lived assets in 69 stores to their estimated fair value. During 2006, division profit declined primarily due to the fashion shift from higher priced marquee footwear to lower priced low-profile footwear styles and a highly competitive retail environment, particularly for the sale of low-profile footwear styles. The charge was comprised primarily of stores located in the U.K. and France.

3. Staff Accounting Bulletin No. 108

In September 2006, the SEC issued Staff Accounting Bulletin No. 108 ("SAB 108") "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements," that provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. There are two widely recognized methods for quantifying the effects of financial statement misstatements: the "rollover" or income statement method and the "iron curtain" or balance sheet method. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach ("dual method") and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. The Company had historically evaluated uncorrected misstatements using the "rollover" method. SAB 108 permits companies to apply its provisions initially by either (i) restating prior financial statements as if the provisions had always been applied or (ii) recording the cumulative effect of initially applying SAB 108 as adjustments to the carrying value of assets and liabilities as of the beginning of 2006 with an offsetting adjustment recorded to the opening balance of shareholders' equity.

The Company believes its prior period assessments of uncorrected misstatements and the conclusions reached regarding its quantitative and qualitative assessments of materiality of such items, both individually and in the aggregate, were appropriate. These items did not significantly affect 2005 as these items originated in earlier periods. In accordance with SAB 108, the Company has adjusted its opening retained earnings for 2006 for the items described below.

(in millions)	Adjustment at Jan. 29, 2006

Accrued liabilities[1]	$ 3.4
Revenue recognition[2]	2.8
Inventory valuation[3]	4.2
	10.4
Provision for income taxes	4.1
Decrease to shareholders equity	$ 6.3

(1) Accrued liabilities The Company understated its accrued liabilities for certain items, such as telecommunications, utilities and property taxes in years prior to 2003. These items originated when the Company was accruing for these items on a calendar year rather than a fiscal year basis.

(2) Revenue recognition The Company had historically recorded revenue from its catalog and Internet operations when the product was shipped to the customer, rather than upon the actual receipt of the product by the customer.

(3) Inventory valuation The Company did not properly recognize the permanent reduction of the retail value of its inventory upon the transfer to clearance stores. The Company provided a reserve for the value of this inventory that had not been marked down to current selling prices.

4. Segment Information

The Company has determined that its reportable segments are those that are based on its method of internal reporting. As of February 2, 2008, the Company has two reportable segments, Athletic Stores and Direct-to-Customers. The Company also operated the Family Footwear segment which included the retail format under the Footquarters brand name through the second quarter of 2007. During the third quarter, the Company converted the Footquarters stores, which were the only stores reported under the Family Footwear segment, to Foot Locker and Champs Sports outlet stores. The Company has concluded that the Footquarters store closings are not discontinued operations pursuant to SFAS No. 144.

The accounting policies of both segments are the same as those described in the Summary of Significant Accounting Policies. The Company evaluates performance based on several factors, of which the primary financial measure is division results. Division profit reflects (loss) income from continuing operations before income taxes, corporate expense, non-operating income, and net interest expense.

Sales

	2007	2006 (in millions)	2005
Athletic Stores	$ 5,071	$ 5,370	$ 5,272
Direct-to-Customers	364	380	381
Family Footwear	2		
Total sales	$ 5,437	$ 5,750	$ 5,653

Operating Results

	2007	2006 (in millions)	2005
Athletic Stores[1]	$ (27)	$ 405	$ 419
Direct-to-Customers	40	45	48
Family Footwear	(6)		
	7	450	467
Restructuring income (charge)[2]	2	(1)	
Division profit	9	449	467
Corporate expense	(59)	(68)	(58)
Operating (loss) profit	(50)	381	409

Other income[3]	1	14	6
Interest expense, net	1	3	10
(Loss) income from continuing operations before income taxes	$ (50)	$ 392	$ 405

(1) The fiscal year ended February 2, 2008 includes a $128 million charge representing impairment and store closing costs related to the Company's U.S. operations. The fiscal year ended February 3, 2007, included a $17 million non-cash impairment charge related to the Company's European operations.

(2) During 2007, the Company adjusted its 1993 Repositioning and 1991 Restructuring reserve by $2 million primarily due to favorable lease terminations. During 2006, the Company recorded a restructuring charge of $1 million, which represented a revision to the original estimate of the lease liability associated with the guarantee of The San Francisco Music Box Company distribution center. These amounts are included in selling, general and administrative expenses in the Condensed Consolidated Statements of Operations.

(3) 2007 includes $1 million gain related to a final settlement with the Company's insurance carriers of a claim related to a store damaged by fire in 2006 and $1 million gain on the sale of two of its lease interests in Europe. These gains were offset primarily by premiums paid for foreign currency option contracts.

2006 includes $4 million gain on lease terminations; $8 million of insurance proceeds related to the 2005 hurricane; and $2 million gain on debt repurchase.

2005 includes a $3 million gain from insurance recoveries associated with Hurricane Katrina. Additionally, $3 million represented a net gain on foreign currency option contracts that were entered into by the Company to mitigate the effect of fluctuating foreign exchange rates on the reporting of euro dominated earnings.

	Depreciation and Amortization			Capital Expenditures			Total Assets		
	2007	**2006**	**2005**	**2007**	**2006 (in millions)**	**2005**	**2007**	**2006**	**2005**
Athletic Stores	$ 146	$ 147	$ 141	$ 125	$ 135	$ 137	$ 2,298	$ 2,374	$ 2,322
Direct-to-Customers	6	6	6	7	4	6	197	195	196
	152	153	147	132	139	143	2,495	2,569	2,518
Corporate	14	22	24	16	26	12	753	680	794
Total Company	$ 166	$ 175	$ 171	$ 148	$ 165	$ 155	$ 3,248	$ 3,249	$ 3,312

Sales and long-lived asset information by geographic area as of and for the fiscal years ended February 2, 2008, February 3, 2007 and January 28, 2006 are presented below. Sales are attributed to the country in which the sales originate, which is where the legal subsidiary is domiciled. Long-lived assets reflect property and equipment. The Company's sales in Italy, Canada, and France represent approximately 21, 18, and 14 percent, respectively, of the International category's sales for the period ended February 2, 2008. No other individual country included in the International category is significant.

Sales

	2007	**2006 (in millions)**	**2005**
United States	$ 3,991	$ 4,356	$ 4,257
International	1,446	1,394	1,396

Total sales	$5,437	$5,750	$5,653

Long-Lived Assets

	2007	2006 (in millions)	2005
United States	$368	$504	$523
International	153	150	152
Total long-lived assets	$521	$654	$675

5. Other Income

Other income was $1 million, $14 million and $6 million for 2007, 2006 and 2005, respectively. Included in other income are non-operating items, such as the effect of foreign currency option contracts, sales of lease interests and insurance proceeds.

In 2007, other income includes a $1 million gain related to a final settlement with the Company's insurance carriers of a claim related to a store damaged by fire in 2006. Additionally, the Company sold two of its lease interests in Europe for a gain of $1 million. These gains were offset primarily by premiums paid for foreign currency option contracts.

In 2006, other income includes a gain of $8 million related to a final settlement with the Company's insurance carriers of claims related to Hurricane Katrina, income of $2 million related to the purchase and retirement of debt and lease termination income of $4 million. The Company purchased and retired $38 million of its $200 million 8.50 percent debentures payable in 2022, at a $2 million discount from face value. During 2006, the Company terminated two of its leases and recorded a net gain of $4 million.

In 2005, the Company recorded a net gain of $3 million related to foreign currency option contracts that were entered into by the Company to mitigate the effect of fluctuating foreign exchange rates on the reporting of euro denominated earnings. Additionally, the Company recorded a gain of $3 million of insurance recoveries in excess of losses associated with Hurricane Katrina.

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6. Short-Term Investments

The Company's auction rate security investments are accounted for as available-for-sale securities. The following represents the composition of the Company's auction rate securities by underlying investment.

	2007	2006 (in millions)
Tax exempt municipal bonds	$ —	$ 44
Equity securities	5	205
	$ 5	$ 249

With the liquidity issues experienced in the global credit and capital markets, the Company's preferred stock auction rate security, having a face value of $7 million, has experienced failed auctions. The Company determined that a temporary impairment has occurred and therefore has recorded a charge of $2 million, with no tax benefit, to accumulated other comprehensive loss as of February 2, 2008. This security will continue to accrue interest at the contractual rate and will be auctioned every 90 days until the auction succeeds. Based on the relatively small size of this investment and the Company's ability to access cash and other short-term investments, and expected operating cash flows, we do not anticipate the lack of liquidity on this investment will affect our ability to operate our business as usual.

7. Merchandise Inventories

	2007	2006
	(in millions)	
LIFO inventories	$ 907	$ 967
FIFO inventories	374	336
Total merchandise inventories	$ 1,281	$ 1,303

The value of the Company’s LIFO inventories, as calculated on a LIFO basis, approximates their value as calculated on a FIFO basis.

8. Other Current Assets

	2007	2006
	(in millions)	
Net receivables	$ 50	$ 59
Prepaid expenses and other current assets	34	36
Prepaid rent	65	62
Prepaid income taxes	70	67
Deferred taxes	53	21
Investments	—	14
Northern Group note receivable	14	1
Current tax asset	1	—
Fair value of derivative contracts	3	1
	$ 290	$ 261

9. Property and Equipment, Net

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

10. Goodwill

	2007	2006
	(in millions)	
Athletic Stores	$ 186	$ 184
Direct-to-Customers	80	80
	$ 266	$ 264

The effect of foreign exchange fluctuations for the fiscal year ended February 2, 2008 increased goodwill by $2 million, resulting from the strengthening of the euro in relation to the U.S. dollar. 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.

11. Intangible Assets, net

	February 2, 2008				February 3, 2007		
(in millions)	Gross value	Accum. amort.	Net Value (1)	Wtd. Avg. Useful Life in Years	Gross value	Accum. amort.	Net Value (1)
Finite life intangible assets							
Lease acquisition costs	$ 198	$ (125)	$ 73	11.9	$ 178	$ (98)	$ 80
Trademark	21	(4)	17	20.0	21	(3)	18
Loyalty program	1	(1)	—	2.0	1	(1)	—
Favorable leases	10	(7)	3	3.7	9	(5)	4
Total finite life intangible assets	230	(137)	93	12.3	209	(107)	102
Intangible assets not subject to amortization	3	—	3		3	—	3
Total intangible assets	$ 233	$ (137)	$ 96		$ 212	$ (107)	$ 105

(1) Includes effect of foreign currency translation of $10 million in 2007, $5 million in 2006 and $8 million in 2005 primarily related to the strengthening of the euro in relation to the U.S. dollar.

Intangible assets not subject to amortization at February 2, 2008 and February 3, 2007, include $3 million related to the trademark of the 11 stores acquired in the Republic of Ireland.

Lease acquisition costs represent amounts that are required to secure prime lease locations and other lease rights, primarily in Europe. Included in finite life intangibles, as a result of the Footaction and Republic of Ireland purchases, are the trademark for the Footaction name, amounts paid for leased locations with rents below their fair value for both acquisitions and amounts paid to obtain names of members of the Footaction loyalty program.

Amortization expense for the intangibles subject to amortization was approximately $19 million for both 2007 and 2006, and $18 for 2005. Annual estimated amortization expense for finite life intangible assets is expected to approximate $18 million for 2008, $17 million for 2009, $15 million for 2010, $12 million for 2011 and $9 million for 2012.

12. Other Assets

	2007	2006
	(in millions)	
Deferred tax costs	$ 9	$ 21
Prepaid income taxes	6	—
Income tax asset	2	—
Investments and note receivable	—	7
Northern Group note receivable, net of current portion	—	10
Fair value of derivative contracts	4	—
Pension benefits	—	8
Other	37	37
	$ 58	$ 83

13. Accrued and Other Liabilities

	2007	2006
	(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	68	65
	$ 268	$ 246

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

14. Revolving Credit Facility

At February 2, 2008, the Company had unused domestic lines of credit of $189 million, pursuant to a $200 million unsecured revolving credit agreement. $11 million of the line of credit was committed to support standby letters of credit. These letters of credit are primarily used for insurance programs.

In May 2004, shortly after the Footaction acquisition, the Company amended its revolving credit agreement, thereby extending the maturity date to May 2009 from July 2006. In October 2007, the Company amended its revolving credit agreement to provide for a one-year extension of the revolving credit facility to May 19, 2010 and a reduction in the fixed charge coverage ratio to no less than 1.25:1 for the fourth quarter of 2007 and the first quarter of 2008, increasing to 2.0:1 by the first quarter of 2010. The amendment also permits the payment of dividends by the Company of up to $90 million in 2008 and up to $100 million for each year thereafter. With regard to stock repurchases, the amendment provides that not more than $50 million in the aggregate may be expended after October 26, 2007 unless the fixed charge coverage ratio is at least 2.0:1 for the quarter immediately preceding any such repurchase and the Company has delivered its annual audited financial statements with respect to 2007.

Deferred financing fees are amortized over the life of the facility on a straight-line basis, which is comparable to the interest method. The unamortized balance at February 2, 2008 is approximately $1.4 million. Interest is determined at the time of borrowing based on variable rates and the Company's fixed charge coverage ratio, as defined in the agreement. The rates range from LIBOR plus 0.875 percent to LIBOR plus 1.625 percent. The quarterly facility fees paid on the unused portion during 2007 and 2006, which are also based on the Company's fixed charge coverage ratio, ranged from 0.175 percent to 0.500 percent. There were no short-term borrowings during 2007 or 2006.

Interest expense, including facility fees, related to the revolving credit facility was $2 million in 2007, 2006, and 2005.

15. Long-Term Debt and Obligations under Capital Leases

In May 2004, the Company obtained a 5-year, $175 million amortizing term loan from the bank group participating in its existing revolving credit facility to finance a portion of the purchase price of the Footaction stores. The interest rate on the LIBOR-based, floating-rate loan was 5.4 percent on February 2, 2008 and 6.5 percent on February 3, 2007. The loan requires minimum principal payments each May, equal to a percentage of

the original principal amount of 10 percent in 2006, 15 percent in years 2007 and 2008 and 50 percent in year 2009. Closing and upfront fees totaling approximately $1 million were paid for the term loan and these fees are being amortized using the interest rate method as determined by the principal repayment schedule. During 2007, 2006 and 2005 the Company repaid $2 million, $50 million, and $35 million, respectively, with the outstanding amount of $88 million due in 2009.

The Company purchased and retired $38 million of the $200 million 8.50 percent debentures payable in 2022 at a $2 million discount from face value during 2006. During 2007, the Company purchased and retired an additional $5 million bringing the outstanding amount to $129 million as of February 2, 2008. The Company has various interest rate swap agreements, which convert $100 million of the 8.50 percent debentures from a fixed interest rate to a variable interest rate, which are collectively classified as a fair value hedge. The net fair value of the interest rate swaps at February 2, 2008 was an asset of $4 million, which was included in other assets, the carrying value of the 8.50 percent debentures was increased by the corresponding amount. The net fair value of the interest rate swaps at February 3, 2007 was a liability of $4 million, which was included in other liabilities, the carrying value of the 8.50 percent debentures was decreased by the corresponding amount.

During 2007, the Company’s $14 million Industrial Revenue Bond, which was accounted for as a capital lease matured. Accordingly, the Company repaid this amount.

Following is a summary of long-term debt and obligations under capital leases:

	2007	2006
	(in millions)	
8.50% debentures payable 2022	$ 133	$ 130
$175 million term loan	88	90
Total long-term debt	221	220
Obligations under capital leases	—	14
	221	234
Less: Current portion	—	14
	$ 221	$ 220

Maturities of long-term debt in future periods are:

	Long-Term Debt (in millions)
2008	$ —
2009	88
2010 -2012	—
Thereafter	133
Less: Current portion	—
	$ 221

Interest expense related to long-term debt and capital lease obligations, including the effect of the interest rate swaps and the amortization of the associated debt issuance costs was $18 million in 2007 and $20 million in both 2006 and 2005. The effect of the interest rate swaps was not significant for the years ended February 2, 2008 and February 3, 2007. The effect of the interest rate swaps resulted in a combined reduction in interest expense of $1 million in 2005.

16. Leases

The Company is obligated under operating leases for almost all of its store properties. Some of the store leases contain renewal options with varying terms and conditions. Management expects that in the normal course of business, expiring leases will generally be renewed or, upon making a decision to relocate, replaced by leases on other premises. Operating lease periods generally range from 5 to 10 years. Certain leases provide for additional rent payments based on a percentage of store sales. Rent expense includes insurance, maintenance, and other costs as required by some of the Company's leases.

Rent expense consists of the following:

	2007	2006	2005
		(in millions)	
Minimum rent	$ 521	$ 496	$ 489
Other occupancy expenses	151	145	141
Contingent rent based on sales	17	21	13
Sublease income	(1)	(1)	(1)
Total rent expense	$ 688	$ 661	$ 642

Future minimum lease payments under non-cancelable operating leases are:

	(in millions)
2008	$ 487
2009	434
2010	398
2011	354
2012	297
Thereafter	823
Total operating lease commitments	$ 2,793

17. Other Liabilities

	2007	2006
	(in millions)	
Pension benefits	$ 35	$ 21
Postretirement benefits	9	11
Straight-line rent liability	99	91
Income taxes	29	24
Deferred taxes	15	21
Workers' compensation / general liability reserves	13	12
Reserve for discontinued operations	9	12
Repositioning and restructuring reserves	2	3
Fair value of derivatives	32	12
Unfavorable leases	2	2
Other	10	9
	$ 255	$ 218

18. Discontinued Operations

On January 23, 2001, the Company announced that it was exiting its 694-store Northern Group segment. During the second quarter of 2001, the Company completed the liquidation of the 324 stores in the United States. On September 28, 2001, the Company completed the stock transfer of the 370 Northern Group stores in Canada, through one of its wholly owned subsidiaries for approximately CAD$59 million, which was paid in the form of a

note. Over the last several years, the note has been amended and payments have been received, however the interest and payment terms remained unchanged. The note is required to be repaid upon the occurrence of "payment events," as defined in the purchase agreement, but no later than September 28, 2008. As of February 2, 2008, CAD$15.5 million remains outstanding on the note. The fair value of the note at February 2, 2008 is $14 million which is classified as a current receivable. At February 3, 2007, $1 million was classified as a current receivable with the remainder classified as long-term within other assets in the accompanying Consolidated Balance Sheets. All scheduled principal and interest payments have been received in accordance with the terms of the note. During 2006, the Company revised its estimates related to the U.S. Northern store reserve resulting in a reduction of $2 million.

Future adjustments, if any, to the carrying value of the note will be recorded pursuant to SEC Staff Accounting Bulletin Topic 5:Z:5, "Accounting and Disclosure Regarding Discontinued Operations," which requires changes in the carrying value of assets received as consideration from the disposal of a discontinued operation to be classified within continuing operations. Interest income will also be recorded within continuing operations. The Company will recognize an impairment loss when, and if, circumstances indicate that the carrying value of the note may not be recoverable. Such circumstances would include deterioration in the business, as evidenced by significant operating losses incurred by the purchaser or nonpayment of an amount due under the terms of the note. The purchaser has made all payments required under the terms of the note; however, the business has sustained unexpected operating losses during the past fiscal year. The Company has evaluated the projected performance of the business and will continue to monitor its results during the coming year.

Another wholly owned subsidiary of the Company was the assignor of the store leases involved in the transaction and therefore retains potential liability for such leases. As the assignor of the Northern Canada leases, the Company remained secondarily liable under these leases. As of February 2, 2008, the Company estimates that its gross contingent lease liability is CAD$5 million (approximately US$5 million). The Company currently estimates the expected value of the lease liability to be insignificant. The Company believes that, because it is secondarily liable on the leases, it is unlikely that it would be required to make such contingent payments.

In 1998, the Company exited both its International General Merchandise and Specialty Footwear segments. In 1997, the Company exited its Domestic General Merchandise segment. During 2007, the Company adjusted the International General Merchandise by $3 million, reflecting favorable lease terminations and to revise estimates on its lease liability. During 2006, the Company adjusted its International General Merchandise reserve by $2 million, reflecting favorable lease terminations. During 2005, the Company recorded a charge of $2 million to revise estimates on its lease liability for one store in the International General Merchandise segment.

The major components of the pre-tax losses (gains) on disposal and disposition activity related to the reserves are presented below. The remaining reserve balances as of February 2, 2008 primarily represent lease obligations; $14 million is expected to be utilized within twelve months and the remaining $9 million thereafter.