

LOWES COMPANIES INC
Form 10-Q
September 05, 2007

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

FORM 10-Q

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

For the quarterly period ended August 3, 2007

Commission file number 1-7898

LOWE'S COMPANIES, INC.

(Exact name of registrant as specified in its charter)

NORTH CAROLINA

(State or other jurisdiction of incorporation or organization)

56-0578072

(I.R.S. Employer Identification No.)

1000 Lowe's Blvd., Mooresville, NC

(Address of principal executive offices)

28117

(Zip Code)

Registrant's telephone number, including area code

(704) 758-1000

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.

x Yes o No

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

Large accelerated filer **x** Accelerated filer **o** Non-accelerated filer **o**

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

o Yes x No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

CLASS	OUTSTANDING AT AUGUST 31, 2007
Common Stock, \$.50 par value	1,478,600,654

LOWE'S COMPANIES, INC.

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Part I - FINANCIAL INFORMATION**Item 1. Financial Statements****Lowe's Companies, Inc.****Consolidated Balance****Sheets**

In Millions, Except Par Value

Data

	(Unaudited) August 3, 2007	(Unaudited) August 4, 2006	February 2, 2007
Assets			
Current assets:			
Cash and cash equivalents	\$ 337	\$ 316	\$ 364
Short-term investments	325	456	432
Merchandise inventory - net	7,799	7,176	7,144
Deferred income taxes - net	209	165	161
Other current assets	181	215	213
Total current assets	8,851	8,328	8,314
Property, less accumulated depreciation	19,825	17,321	18,971
Long-term investments	627	200	165
Other assets	341	188	317
Total assets	\$ 29,644	\$ 26,037	\$ 27,767
Liabilities and shareholders' equity			
Current liabilities:			
Short-term borrowings	\$ 555	\$ -	\$ 23
Current maturities of long-term debt	85	32	88
Accounts payable	4,167	3,629	3,524
Accrued salaries and wages	371	371	425
Self-insurance liabilities	726	653	650
Deferred revenue	819	826	731
Other current liabilities	1,317	1,151	1,098
Total current liabilities	8,040	6,662	6,539

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Long-term debt, excluding current maturities	4,301	3,410	4,325
Deferred income taxes - net	628	711	735
Other long-term liabilities	706	334	443
Total liabilities	13,675	11,117	12,042
Shareholders' equity:			
Preferred stock - \$5 par value, none issued	-	-	-
Common stock - \$.50 par value;			
Shares issued and outstanding			
August 3, 2007	1,485		
August 4, 2006	1,538		
February 2, 2007	1,525	742	769
Capital in excess of par value	11	307	102
Retained earnings	15,210	13,843	14,860
Accumulated other comprehensive income	6	1	1
Total shareholders' equity	15,969	14,920	15,725
Total liabilities and shareholders' equity	\$ 29,644	\$ 26,037	\$ 27,767

See accompanying notes to the consolidated financial statements (unaudited).

**Lowe's Companies,
Inc.**
**Consolidated Statements of Current
and Retained Earnings (Unaudited)**
In Millions, Except
Per Share Data

	Three Months Ended				Six Months Ended			
	August 3, 2007		August 4, 2006		August 3, 2007		August 4, 2006	
Current Earnings	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Net sales	\$ 14,167	100.00	\$ 13,389	100.00	\$ 26,338	100.00	\$ 25,310	100.00
Cost of sales	9,284	65.53	8,911	66.56	17,195	65.29	16,664	65.84
Gross margin	4,883	34.47	4,478	33.44	9,143	34.71	8,646	34.16
Expenses:								
Selling, general and administrative	2,839	20.04	2,617	19.54	5,524	20.97	5,083	20.09
Store opening costs	26	0.18	28	0.21	38	0.14	53	0.20
Depreciation	332	2.35	283	2.11	656	2.49	557	2.20
Interest - net	50	0.35	30	0.23	97	0.37	65	0.26
Total expenses	3,247	22.92	2,958	22.09	6,315	23.97	5,758	22.75
Pre-tax earnings	1,636	11.55	1,520	11.35	2,828	10.74	2,888	11.41
Income tax provision	617	4.36	585	4.37	1,070	4.07	1,112	4.39
Net earnings	\$ 1,019	7.19	\$ 935	6.98	\$ 1,758	6.67	\$ 1,776	7.02
Weighted average shares outstanding - basic								
	1,490		1,541		1,500		1,549	
Basic earnings per share	\$ 0.68		\$ 0.61		\$ 1.17		\$ 1.15	
Weighted average shares outstanding - diluted								
	1,518		1,571		1,530		1,580	
Diluted earnings per share	\$ 0.67		\$ 0.60		\$ 1.15		\$ 1.13	

Cash dividends per share	\$ 0.08	\$ 0.05	\$ 0.13	\$ 0.08
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Retained Earnings

Balance at beginning of period	\$ 14,968	\$ 12,985	\$ 14,860	\$ 12,191
Cumulative effect adjustment (Note 9)	-	-	(8)	-
Net earnings	1,019	935	1,758	1,776
Cash dividends	(119)	(77)	(194)	(124)
Share repurchases	(658)	-	(1,206)	-
Balance at end of period	\$ 15,210	\$ 13,843	\$ 15,210	\$ 13,843

See accompanying notes to the consolidated financial statements (unaudited).

Lowe's Companies, Inc.
Consolidated Statements of Cash Flows (Unaudited)
 In Millions

	Six Months Ended	
	August 3, 2007	August 4, 2006
Cash flows from operating activities:		
Net earnings	\$ 1,758	\$ 1,776
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	701	591
Deferred income taxes	3	(34)
Loss on disposition/writedown of fixed and other assets	17	5
Share-based payment expense	45	35
Changes in operating assets and liabilities:		
Merchandise inventory - net	(655)	(541)
Other operating assets	56	(93)
Accounts payable	643	797
Other operating liabilities	510	68
Net cash provided by operating activities	3,078	2,604
Cash flows from investing activities:		
Purchases of short-term investments	(368)	(228)
Proceeds from sale/maturity of short-term investments	524	399
Purchases of long-term investments	(1,102)	(225)
Proceeds from sale/maturity of long-term investments	589	141
(Increase) decrease in other long-term assets	(23)	13
Fixed assets acquired	(1,698)	(1,556)
Proceeds from the sale of fixed and other long-term assets	26	23
Net cash used in investing activities	(2,052)	(1,433)
Cash flows from financing activities:		
Net increase in short-term borrowings	532	-
Proceeds from issuance of long-term debt	4	-
Repayment of long-term debt	(31)	(16)
Proceeds from issuance of common stock under employee stock purchase plan	40	36
Proceeds from issuance of common stock from stock options exercised	43	48
Cash dividend payments	(194)	(124)
Repurchase of common stock	(1,450)	(1,226)
Excess tax benefits of share-based payments	3	4
Net cash used in financing activities	(1,053)	(1,278)
Net decrease in cash and cash equivalents	(27)	(107)
Cash and cash equivalents, beginning of period	364	423
Cash and cash equivalents, end of period	\$ 337	\$ 316

See accompanying notes to the consolidated financial statements (unaudited).

Lowe's Companies, Inc.
Notes to Consolidated Financial Statements (Unaudited)

Note 1: Basis of Presentation - The accompanying consolidated financial statements (unaudited) and notes to consolidated financial statements (unaudited) are presented in accordance with the rules and regulations of the Securities and Exchange Commission and do not include all the disclosures normally required in annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America. The consolidated financial statements (unaudited), in the opinion of management, contain all adjustments necessary to present fairly the financial position as of August 3, 2007 and August 4, 2006, and the results of operations for the three and six months ended August 3, 2007 and August 4, 2006, and cash flows for the six months ended August 3, 2007 and August 4, 2006.

These interim consolidated financial statements (unaudited) should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Lowe's Companies, Inc. (the Company) Annual Report on Form 10-K for the fiscal year ended February 2, 2007 (the Annual Report). The financial results for the interim periods may not be indicative of the financial results for the entire fiscal year.

Certain prior period amounts have been reclassified to conform to current classifications.

Note 2: Restricted Investment Balances - Short-term and long-term investments include restricted balances pledged as collateral for letters of credit for the Company's extended warranty program and for a portion of the Company's casualty insurance and installed sales program liabilities. Restricted balances included in short-term investments were \$178 million at August 3, 2007, \$182 million at August 4, 2006, and \$248 million at February 2, 2007. Restricted balances included in long-term investments were \$102 million at August 3, 2007, \$27 million at August 4, 2006, and \$32 million at February 2, 2007.

Note 3: Property - Property is shown net of accumulated depreciation of \$6.8 billion at August 3, 2007, \$5.6 billion at August 4, 2006, and \$6.1 billion at February 2, 2007.

Note 4: Short-Term Borrowings - On June 15, 2007, the Company entered into an Amended and Restated Credit Agreement (Amended Facility) to modify the senior credit facility dated July 30, 2004, which provided for borrowings of up to \$1 billion through July 2009. The Amended Facility extends the maturity date to June 2012 and provides for borrowings of up to \$1.75 billion. The Amended Facility is available to support the Company's commercial paper and revolving credit programs. Borrowings made are unsecured and are priced at a fixed rate based upon market conditions at the time of funding in accordance with the terms of the Amended Facility. The Amended Facility contains certain restrictive covenants, which include maintenance of a debt leverage ratio as defined by the Amended Facility. The Company was in compliance with those covenants at August 3, 2007. Seventeen banking institutions are participating in the \$1.75 billion Amended Facility. As of August 3, 2007, there was \$555 million outstanding under the commercial paper program. The weighted-average interest rate on the short-term borrowings was 5.3%.

Note 5: Extended Warranties - Lowe's sells separately-priced extended warranty contracts under a Lowe's-branded program for which the Company is ultimately self-insured. The Company recognizes revenue from extended warranty sales on a straight-line basis over the respective contract term. Extended warranty contract terms primarily range from one to four years from the date of purchase or the end of the manufacturer's warranty, as applicable. Deferred revenues related to the Company's extended warranty sales were \$373 million and \$273 million at August 3, 2007 and August 4, 2006, respectively. Extended warranty deferred revenue is included in other long-term liabilities in the accompanying consolidated balance sheets. Changes in deferred revenue for extended warranty contracts are summarized as follows:

(In millions)	Three Months Ended		Six Months Ended	
	August 3, 2007	August 4, 2006	August 3, 2007	August 4, 2006
Extended warranty deferred revenue, beginning of period	\$ 343	\$ 238	\$ 315	\$ 206
Additions to deferred revenue	50	43	94	81
Deferred revenue recognized	(20)	(8)	(36)	(14)
Extended warranty deferred revenue, end of period	\$ 373	\$ 273	\$ 373	\$ 273

Incremental direct acquisition costs associated with the sale of extended warranties are also deferred and recognized as expense on a straight-line basis over the respective contract term. Deferred costs associated with extended warranty contracts were \$85 million and \$64 million at August 3, 2007 and August 4, 2006, respectively. Extended warranty deferred costs are included in other assets (non-current) in the accompanying consolidated balance sheets. All other costs, such as costs of services performed under the contract, general and administrative expenses and advertising expenses are expensed as incurred.

The liability for extended warranty claims incurred is included in self-insurance liabilities in the accompanying consolidated balance sheets. Changes in the liability for extended warranty claims are summarized as follows:

(In millions)	Three Months Ended		Six Months Ended	
	August 3, 2007	August 4, 2006	August 3, 2007	August 4, 2006
Liability for extended warranty claims, beginning of period	\$ 9	\$ -	\$ 10	\$ -
Accrual for claims incurred	11	2	19	2
Claim payments	(2)	(2)	(11)	(2)
Liability for extended warranty claims, end of period	\$ 18	\$ -	\$ 18	\$ -

Note 6: Shareholders' Equity - On May 25, 2007, the Company's Board of Directors authorized up to an additional \$3 billion in share repurchases and extended the period of the share repurchase program through fiscal 2009. The Company repurchased 45.7 million and 38.1 million common shares under the share repurchase program during the first six months of fiscal 2007 and 2006, respectively. The total cost of the share repurchases was \$1.5 billion (of which \$1.2 billion was recorded as a reduction in retained earnings, after capital in excess of par value was depleted) and \$1.2 billion, respectively. As of August 3, 2007, the Company had remaining authorization under the share repurchase program of \$3.0 billion.

During the first six months of fiscal 2007, holders of \$6 million principal amount, \$4 million carrying amount, of the Company's convertible notes issued in February 2001 exercised their right to convert the notes into approximately 184,000 shares of the Company's common stock at the rate of 32.896 shares per note. During the first six months of

fiscal 2006, holders of \$107 million principal amount, \$74 million carrying amount, of the Company's convertible notes issued in February 2001 exercised their right to convert the notes into 3.5 million shares of the Company's common stock at the rate of 32.896 shares per note.

During the first six months of fiscal 2007 and 2006, holders of an insignificant number of the Company's senior convertible notes issued in October 2001 exercised their right to convert the notes into shares of the Company's common stock at the rate of 34.424 shares per note.

Note 7: Comprehensive Income - Comprehensive income represents changes in shareholders' equity from non-owner sources and is comprised primarily of net earnings plus or minus unrealized gains or losses on available-for-sale securities, as well as foreign currency translation adjustments. For the three months ended August 3, 2007, both comprehensive income and net earnings totaled \$1.0 billion. For the three months ended August 4, 2006, both comprehensive income and net earnings totaled \$0.9 billion. For each of the six month periods ended August 3, 2007 and August 4, 2006, both comprehensive income and net earnings totaled \$1.8 billion.

Note 8: Accounting for Share-Based Payment - During the three months ended August 3, 2007, the Company granted under its 2006 Long-Term Incentive Plan an insignificant number of share-based payment awards. During the six months ended August 3, 2007, the Company granted under its 2006 Long-Term Incentive Plan 1.8 million stock options at an exercise price of not less than the closing market price of a share of the Company's common stock on the date of grant. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model, which resulted in a weighted-average grant date fair value per share of \$8.19. The Company also granted 1.8 million restricted stock awards and 0.6 million performance-based restricted stock awards with a weighted-average grant date fair value per share of \$31.93 and \$32.21, respectively. See Note 9 to the consolidated financial statements in the Annual Report for additional information regarding general terms and methods of valuation for stock options and restricted stock awards.

Performance-based restricted stock awards are valued at the market price of a share of the Company's common stock on the date of grant. In general, these awards vest at the end of a three-year service period from the date of grant only if the performance goal specified in the performance-based restricted stock agreement is achieved. The performance goal is based on targeted Company average return on non-cash assets, as such term is defined in the performance-based restricted stock agreement. These awards are expensed on a straight-line basis over the requisite service period, based on the probability of achieving the performance goal. The Company uses historical data to estimate the timing and amount of forfeitures.

Total unrecognized share-based payment expense for all share-based payment plans was \$141 million at August 3, 2007, of which \$36 million is expected to be recognized in 2007, \$59 million in 2008, \$36 million in 2009 and \$10 million thereafter. This results in these amounts being recognized over a weighted-average period of 1.2 years.

Note 9: Accounting for Uncertainty in Income Taxes - The Company adopted Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 48, "Accounting for Uncertainty in Income Taxes", effective February 3, 2007. As a result of the implementation, the Company recognized an \$8 million net increase to the reserve for uncertain tax positions. This increase was accounted for as a cumulative effect adjustment and recognized as a reduction in beginning retained earnings in the consolidated balance sheet (unaudited). Including the cumulative effect adjustment, the Company had approximately \$214 million of total unrecognized tax benefits (including penalties and interest) as of February 3, 2007. Of this total, \$56 million (net of the federal benefit on state issues) represents the amount of unrecognized tax benefits that, if recognized, would favorably impact the effective income tax rate in any future periods. The remaining \$158 million represents the amount of unrecognized tax benefits for which the ultimate deductibility is certain, but for which there is uncertainty about the timing of deductibility. The timing of such deductibility would not impact the effective tax rate. The Company does not expect any changes in unrecognized tax benefits over the next twelve months to have a significant impact on the results of operations or the financial position of the Company.

The Company is subject to U.S. federal and foreign income tax, as well as income tax in multiple state and local jurisdictions. The Company has substantially concluded all U.S. federal income tax matters for fiscal years through 2003. The Company has substantially concluded all material state, local, and foreign income tax matters for fiscal years through 2002.

The Company includes interest related to tax issues as part of net interest in the consolidated financial statements (unaudited). The Company records any applicable penalties related to tax issues within the income tax provision. The Company had \$21 million accrued for interest and \$7 million accrued for penalties as of February 3, 2007.

Note 10: Earnings Per Share - Basic earnings per share excludes dilution and is computed by dividing the applicable net earnings by the weighted-average number of common shares outstanding for the period. Diluted earnings per share is calculated based on the weighted-average shares of common stock as adjusted for the potential dilutive effect of share-based awards and convertible notes as of the balance sheet date. The following table reconciles earnings per share for the three and six months ended August 3, 2007 and August 4, 2006.

(In millions, except per share data)	Three Months Ended		Six Months Ended	
	August 3, 2007	August 4, 2006	August 3, 2007	August 4, 2006
Basic earnings per share:				
Net earnings	\$ 1,019	\$ 935	\$ 1,758	\$ 1,776
Weighted-average shares outstanding	1,490	1,541	1,500	1,549
Basic earnings per share	\$ 0.68	\$ 0.61	\$ 1.17	\$ 1.15
Diluted earnings per share:				
Net earnings	\$ 1,019	\$ 935	\$ 1,758	\$ 1,776
Net earnings adjustment for interest on convertible notes, net of tax	1	1	2	2
Net earnings, as adjusted	\$ 1,020	\$ 936	\$ 1,760	\$ 1,778
Weighted-average shares outstanding	1,490	1,541	1,500	1,549
Dilutive effect of share-based awards	7	8	9	8
Dilutive effect of convertible notes	21	22	21	23
Weighted-average shares, as adjusted	1,518	1,571	1,530	1,580
Diluted earnings per share	\$ 0.67	\$ 0.60	\$	\$