

APPENDIX A

# Home Depot 2005 Financial Statements



A



### Home Depot 2005 Financial Statements Contents

Management's Responsibility for Financial Statements	A-1
Management's Report on Internal Control over Financial Reporting	A-1
Report of Independent Registered Public Accounting Firm	A-2
Consolidated Statements of Earnings	A-3
Consolidated Balance Sheets	A-4
Consolidated Statements of Stockholders' Equity and Comprehensive Income	A-5
Consolidated Statements of Cash Flows	A-6
Notes to Consolidated Financial Statements—Note 1, Summary of Significant Accounting Policies	A-7–A-13
10-Year Summary of Financial and Operating Results	A-14–A-15

## Item 8. Financial Statements and Supplementary Data.

### Management's Responsibility for Financial Statements

The financial statements presented in this Annual Report have been prepared with integrity and objectivity and are the responsibility of the management of The Home Depot, Inc. These financial statements have been prepared in conformity with U.S. generally accepted accounting principles and properly reflect certain estimates and judgments based upon the best available information.

The financial statements of the Company have been audited by KPMG LLP, an independent registered public accounting firm. Their accompanying report is based upon an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States).

The Audit Committee of the Board of Directors, consisting solely of outside directors, meets five times a year with the independent registered public accounting firm, the internal auditors and representatives of management to discuss auditing and financial reporting matters. In addition, a telephonic meeting is held prior to each quarterly earnings release. The Audit Committee retains the independent registered public accounting firm and regularly reviews the internal accounting controls, the activities of the independent registered public accounting firm and internal auditors and the financial condition of the Company. Both the Company's independent registered public accounting firm and the internal auditors have free access to the Audit Committee.

### Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) promulgated under the Securities Exchange Act of 1934, as amended. Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on our evaluation, our management concluded that our internal control over financial reporting was effective as of January 29, 2006. Our management's assessment of the effectiveness of our internal control over financial reporting as of January 29, 2006 has been audited by KPMG LLP, an independent registered public accounting firm, as stated in its report which is included herein.

/s/ ROBERT L. NARDELLI

Robert L. Nardelli  
Chairman, President &  
Chief Executive Officer

/s/ CAROL B. TOMÉ

Carol B. Tomé  
Executive Vice President &  
Chief Financial Officer





## A-2

## Appendix A Home Depot 2005 Financial Statements

## Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders  
The Home Depot, Inc.:

We have audited the accompanying Consolidated Balance Sheets of The Home Depot, Inc. and subsidiaries as of January 29, 2006 and January 30, 2005, and the related Consolidated Statements of Earnings, Stockholders' Equity and Comprehensive Income, and Cash Flows for each of the fiscal years in the three-year period ended January 29, 2006. 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 The Home Depot, Inc. and subsidiaries as of January 29, 2006 and January 30, 2005, and the results of their operations and their cash flows for each of the fiscal years in the three-year period ended January 29, 2006, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the Consolidated Financial Statements, effective February 3, 2003, the Company changed its method of accounting for cash consideration received from a vendor to conform to Emerging Issues Task Force No. 02-16 and adopted the fair value method of recording stock-based compensation expense in accordance with Statement of Financial Accounting Standards No. 123.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of The Home Depot, Inc. and subsidiaries' internal control over financial reporting as of January 29, 2006, 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 22, 2006 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

/s/ KPMG LLP

Atlanta, Georgia  
March 22, 2006, except as to note 12  
which is as of March 24, 2006



## Appendix A Home Depot 2005 Financial Statements

A-3

**THE HOME DEPOT, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF EARNINGS**

	Fiscal Year Ended <sup>(1)</sup>		
	January 29, 2006	January 30, 2005	February 1, 2004
<i>amounts in millions, except per share data</i>			
<b>NET SALES</b>	<b>\$ 81,511</b>	\$ 73,094	\$ 64,816
Cost of Sales	<b>54,191</b>	48,664	44,236
<b>GROSS PROFIT</b>	<b>27,320</b>	24,430	20,580
Operating Expenses:			
Selling, General and Administrative	<b>16,485</b>	15,256	12,713
Depreciation and Amortization	<b>1,472</b>	1,248	1,021
Total Operating Expenses	<b>17,957</b>	16,504	13,734
<b>OPERATING INCOME</b>	<b>9,363</b>	7,926	6,846
Interest Income (Expense):			
Interest and Investment Income	<b>62</b>	56	59
Interest Expense	<b>(143)</b>	(70)	(62)
Interest, net	<b>(81)</b>	(14)	(3)
<b>EARNINGS BEFORE PROVISION FOR INCOME TAXES</b>	<b>9,282</b>	7,912	6,843
Provision for Income Taxes	<b>3,444</b>	2,911	2,539
<b>NET EARNINGS</b>	<b>\$ 5,838</b>	\$ 5,001	\$ 4,304
Weighted Average Common Shares	<b>2,138</b>	2,207	2,283
<b>BASIC EARNINGS PER SHARE</b>	<b>\$ 2.73</b>	\$ 2.27	\$ 1.88
Diluted Weighted Average Common Shares	<b>2,147</b>	2,216	2,289
<b>DILUTED EARNINGS PER SHARE</b>	<b>\$ 2.72</b>	\$ 2.26	\$ 1.88

(1) Fiscal years ended January 29, 2006, January 30, 2005 and February 1, 2004 include 52 weeks.

See accompanying Notes to Consolidated Financial Statements.

**THE HOME DEPOT, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

	January 29, 2006	January 30, 2005
<i>amounts in millions, except per share data</i>		
<b>ASSETS</b>		
Current Assets:		
Cash and Cash Equivalents	\$ 793	\$ 506
Short-Term Investments	14	1,659
Receivables, net	2,396	1,499
Merchandise Inventories	11,401	10,076
Other Current Assets	742	533
<b>Total Current Assets</b>	<b>15,346</b>	<b>14,273</b>
Property and Equipment, at cost:		
Land	7,924	6,932
Buildings	14,056	12,325
Furniture, Fixtures and Equipment	7,073	6,195
Leasehold Improvements	1,207	1,191
Construction in Progress	843	1,404
Capital Leases	427	390
	31,530	28,437
Less Accumulated Depreciation and Amortization	6,629	5,711
<b>Net Property and Equipment</b>	<b>24,901</b>	<b>22,726</b>
Notes Receivable	348	369
Cost in Excess of the Fair Value of Net Assets Acquired	3,286	1,394
Other Assets	601	258
<b>Total Assets</b>	<b>\$ 44,482</b>	<b>\$ 39,020</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Short-Term Debt	\$ 900	\$ —
Accounts Payable	6,032	5,766
Accrued Salaries and Related Expenses	1,176	1,055
Sales Taxes Payable	488	412
Deferred Revenue	1,757	1,546
Income Taxes Payable	388	161
Current Installments of Long-Term Debt	513	11
Other Accrued Expenses	1,647	1,504
<b>Total Current Liabilities</b>	<b>12,901</b>	<b>10,455</b>
Long-Term Debt, excluding current installments	2,672	2,148
Other Long-Term Liabilities	977	871
Deferred Income Taxes	1,023	1,388
<b>STOCKHOLDERS' EQUITY</b>		
Common Stock, par value \$0.05; authorized: 10,000 shares; issued 2,401 shares at January 29, 2006 and 2,385 shares at January 30, 2005; outstanding 2,124 shares at January 29, 2006 and 2,185 shares at January 30, 2005	120	119
Paid-In Capital	7,287	6,650
Retained Earnings	28,943	23,962
Accumulated Other Comprehensive Income	409	227
Unearned Compensation	(138)	(108)
Treasury Stock, at cost, 277 shares at January 29, 2006 and 200 shares at January 30, 2005	(9,712)	(6,692)
<b>Total Stockholders' Equity</b>	<b>26,909</b>	<b>24,158</b>
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$ 44,482</b>	<b>\$ 39,020</b>

See accompanying Notes to Consolidated Financial Statements.

**A-4**

**THE HOME DEPOT, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS'**  
**EQUITY AND COMPREHENSIVE INCOME**

<i>amounts in millions, except per share data</i>	Common Stock		Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss) <sup>(1)</sup>	Unearned Compensation	Treasury Stock		Total Stockholders' Equity	Comprehensive Income <sup>(2)</sup>
	Shares	Amount					Shares	Amount		
<b>BALANCE, FEBRUARY 2, 2003</b>	<b>2,362</b>	<b>\$ 118</b>	<b>\$ 5,858</b>	<b>\$ 15,971</b>	<b>\$ (82)</b>	<b>(63)</b>	<b>(69)</b>	<b>\$ (2,000)</b>	<b>\$ 19,802</b>	
Net Earnings	—	—	—	4,304	—	—	—	—	4,304	\$ 4,304
Shares Issued Under Employee Stock Plans	11	1	249	—	—	(26)	—	—	224	
Tax Effect of Sale of Option Shares by Employees	—	—	24	—	—	—	—	—	24	
Translation Adjustments	—	—	—	—	172	—	—	—	172	172
Stock Options, Awards and Amortization of Restricted Stock	—	—	53	—	—	13	—	—	66	
Repurchase of Common Stock	—	—	—	—	—	—	(47)	(1,590)	(1,590)	
Cash Dividends (\$0.26 per share)	—	—	—	(595)	—	—	—	—	(595)	
<b>Comprehensive Income</b>										<b>\$ 4,476</b>
<b>BALANCE, FEBRUARY 1, 2004</b>	<b>2,373</b>	<b>\$ 119</b>	<b>\$ 6,184</b>	<b>\$ 19,680</b>	<b>\$ 90</b>	<b>(76)</b>	<b>(116)</b>	<b>\$ (3,590)</b>	<b>\$ 22,407</b>	
Net Earnings	—	—	—	5,001	—	—	—	—	5,001	\$ 5,001
Shares Issued Under Employee Stock Plans	12	—	340	—	—	(54)	—	—	286	
Tax Effect of Sale of Option Shares by Employees	—	—	26	—	—	—	—	—	26	
Translation Adjustments	—	—	—	—	137	—	—	—	137	137
Stock Options, Awards and Amortization of Restricted Stock	—	—	100	—	—	22	—	—	122	
Repurchase of Common Stock	—	—	—	—	—	—	(84)	(3,102)	(3,102)	
Cash Dividends (\$0.325 per share)	—	—	—	(719)	—	—	—	—	(719)	
<b>Comprehensive Income</b>										<b>\$ 5,138</b>
<b>BALANCE, JANUARY 30, 2005</b>	<b>2,385</b>	<b>\$ 119</b>	<b>\$ 6,650</b>	<b>\$ 23,962</b>	<b>\$ 227</b>	<b>(108)</b>	<b>(200)</b>	<b>\$ (6,692)</b>	<b>\$ 24,158</b>	
Net Earnings	—	—	—	5,838	—	—	—	—	5,838	\$ 5,838
Shares Issued Under Employee Stock Plans	16	1	472	—	—	(63)	—	—	410	
Tax Effect of Sale of Option Shares by Employees	—	—	24	—	—	—	—	—	24	
Translation Adjustments	—	—	—	—	182	—	—	—	182	182
Stock Options, Awards and Amortization of Restricted Stock	—	—	141	—	—	33	—	—	174	
Repurchase of Common Stock	—	—	—	—	—	—	(77)	(3,020)	(3,020)	
Cash Dividends (\$0.40 per share)	—	—	—	(857)	—	—	—	—	(857)	
<b>Comprehensive Income</b>										<b>\$ 6,020</b>
<b>BALANCE, JANUARY 29, 2006</b>	<b>2,401</b>	<b>\$ 120</b>	<b>\$ 7,287</b>	<b>\$ 28,943</b>	<b>\$ 409</b>	<b>(138)</b>	<b>(277)</b>	<b>\$ (9,712)</b>	<b>\$ 26,909</b>	

(1) Balance at January 29, 2006 consists primarily of foreign currency translation adjustments.

(2) Components of Comprehensive Income are reported net of related income taxes.

See accompanying Notes to Consolidated Financial Statements.

**THE HOME DEPOT, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Fiscal Year Ended <sup>(1)</sup>		
	January 29, 2006	January 30, 2005	February 1, 2004
<i>amounts in millions</i>			
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net Earnings	\$ 5,838	\$ 5,001	\$ 4,304
Reconciliation of Net Earnings to Net Cash Provided by Operating Activities:			
Depreciation and Amortization	1,579	1,319	1,076
Impairment Related to Disposition of EXPO Real Estate	78	—	—
Stock-Based Compensation Expense	175	125	67
Changes in Assets and Liabilities, net of the effects of acquisitions:			
(Increase) Decrease in Receivables, net	(358)	(266)	25
Increase in Merchandise Inventories	(971)	(849)	(693)
Decrease (Increase) in Other Current Assets	16	29	(49)
Increase in Accounts Payable and Accrued Liabilities	12	917	790
Increase in Deferred Revenue	209	263	279
Increase (Decrease) in Income Taxes Payable	175	2	(27)
(Decrease) Increase in Deferred Income Taxes	(609)	319	605
Increase in Other Long-Term Liabilities	151	119	33
Other	189	(75)	135
<b>Net Cash Provided by Operating Activities</b>	<b>6,484</b>	<b>6,904</b>	<b>6,545</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Capital Expenditures, net of \$51, \$38 and \$47 of non-cash capital expenditures in fiscal 2005, 2004 and 2003, respectively	(3,881)	(3,948)	(3,508)
Purchase of Assets from Off-Balance Sheet Financing Arrangement	—	—	(598)
Payments for Businesses Acquired, net	(2,546)	(727)	(215)
Proceeds from Sales of Property and Equipment	164	96	265
Purchases of Investments	(18,230)	(25,890)	(38,649)
Proceeds from Sales and Maturities of Investments	19,907	25,990	38,534
<b>Net Cash Used in Investing Activities</b>	<b>(4,586)</b>	<b>(4,479)</b>	<b>(4,171)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Proceeds from Short-Term Borrowings, net	900	—	—
Proceeds from Long-Term Borrowings, net of discount	995	995	—
Repayments of Long-Term Debt	(24)	(510)	(9)
Repurchase of Common Stock	(3,040)	(3,106)	(1,554)
Proceeds from Sale of Common Stock, net	414	285	227
Cash Dividends Paid to Stockholders	(857)	(719)	(595)
<b>Net Cash Used in Financing Activities</b>	<b>(1,612)</b>	<b>(3,055)</b>	<b>(1,931)</b>
Increase (Decrease) in Cash and Cash Equivalents	286	(630)	443
Effect of Exchange Rate Changes on Cash and Cash Equivalents	1	33	20
Cash and Cash Equivalents at Beginning of Year	506	1,103	640
<b>Cash and Cash Equivalents at End of Year</b>	<b>\$ 793</b>	<b>\$ 506</b>	<b>\$ 1,103</b>
<b>SUPPLEMENTAL DISCLOSURE OF CASH PAYMENTS MADE FOR:</b>			
Interest, net of interest capitalized	\$ 114	\$ 78	\$ 70
Income Taxes	\$ 3,860	\$ 2,793	\$ 2,037

(1) Fiscal years ended January 29, 2006, January 30, 2005 and February 1, 2004 include 52 weeks.

See accompanying Notes to Consolidated Financial Statements.

**A-6**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES****Business, Consolidation and Presentation**

The Home Depot, Inc. and subsidiaries (the "Company") operate The Home Depot stores, which are full-service, warehouse-style stores averaging approximately 105,000 square feet in size. The stores stock approximately 35,000 to 45,000 different kinds of building materials, home improvement supplies and lawn and garden products that are sold to do-it-yourself customers, do-it-for-me customers, home improvement contractors, tradespeople and building maintenance professionals. In addition, the Company operates EXPO Design Center stores ("EXPO"), which offer products and services primarily related to design and renovation projects, The Home Depot Landscape Supply stores, which service landscape professionals and garden enthusiasts with lawn, landscape and garden products and Home Depot Supply stores and Contractors' Warehouse stores serving primarily professional customers. The Company also operates The Home Depot Floor Stores, which offer primarily flooring products and installation services. At the end of fiscal 2005, the Company was operating 2,042 stores in total, which included 1,793 The Home Depot stores, 34 EXPO Design Center stores, 11 The Home Depot Landscape Supply stores, eight Contractors' Warehouse stores, three Home Depot Supply stores and two The Home Depot Floor Stores in the United States, including the territories of Puerto Rico and the Virgin Islands ("U.S."); 137 The Home Depot stores in Canada and 54 The Home Depot stores in Mexico.

Additionally, Home Depot Supply, through the Company's wholly-owned subsidiaries, distributes products and sells installation services primarily to professional business contractors, businesses and municipalities and operates in three primary areas. Maintenance, Repair and Operations ("MRO") supplies maintenance, repair and operating products primarily to multi-family housing, hospitality and lodging facilities. The second area, Builder, provides products and arranges installation services for production home builders. Professional Supply, the third area, distributes specialty hardware, tools and materials to construction contractors. The Consolidated Financial Statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany transactions have been eliminated in consolidation.

**Fiscal Year**

The Company's fiscal year is a 52 or 53-week period ending on the Sunday nearest to January 31. Fiscal years ended January 29, 2006 ("fiscal 2005"), January 30, 2005 ("fiscal 2004") and February 1, 2004 ("fiscal 2003") include 52 weeks.

**Use of Estimates**

Management of the Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities, the disclosure of contingent assets and liabilities, and reported amounts of revenues and expenses in preparing these financial statements in conformity with generally accepted accounting principles. Actual results could differ from these estimates.

**Fair Value of Financial Instruments**

The carrying amounts of Cash and Cash Equivalents, Receivables, Short-Term Debt and Accounts Payable approximate fair value due to the short-term maturities of these financial instruments. The fair value of the Company's investments is discussed under the caption "Short-Term Investments" in this Note 1. The fair value of the Company's Long-Term Debt is discussed in Note 3.



**A-8****Appendix A** Home Depot 2005 Financial Statements**Cash Equivalents**

The Company considers all highly liquid investments purchased with maturities of three months or less to be cash equivalents. The Company's Cash and Cash Equivalents are carried at fair market value and consist primarily of high-grade commercial paper, money market funds, U.S. government agency securities and tax-exempt notes and bonds.

**Short-Term Investments**

Short-Term Investments at the end of fiscal 2004 are primarily auction rate securities. The interest rates on these securities are typically reset to market prevailing rates every 35 days or less, and in all cases every 90 days or less, but have longer stated maturities. Short-Term Investments are recorded at fair value based on current market rates and are classified as available-for-sale. Changes in the fair value are included in Accumulated Other Comprehensive Income (Loss), net of applicable taxes in the accompanying Consolidated Financial Statements.

**Accounts Receivable**

The Company has an agreement with a third-party service provider who manages the Company's private label credit card program and directly extends credit to customers. In addition, certain subsidiaries of the Company extend credit directly to customers in the ordinary course of business. The receivables due from customers were \$865 million and \$321 million as of January 29, 2006 and January 30, 2005, respectively. The Company's valuation reserve related to accounts receivable was not material as of January 29, 2006 and January 30, 2005.

**Merchandise Inventories**

The majority of the Company's Merchandise Inventories are stated at the lower of cost (first-in, first-out) or market, as determined by the retail inventory method. As the inventory retail value is adjusted regularly to reflect market conditions, the inventory valued using the retail method approximates the lower of cost or market. Certain subsidiaries and distribution centers record Merchandise Inventories at the lower of cost (first-in, first-out) or market, as determined by the cost method. These Merchandise Inventories represent approximately 14% of the total Merchandise Inventories balance. The Company evaluates the inventory valued using the cost method at the end of each quarter to ensure that it is carried at the lower of cost or market. The valuation allowance for Merchandise Inventories valued under the cost method was not material to the Company as of the end of fiscal 2005 and fiscal 2004.

Independent physical inventory counts or cycle counts are taken on a regular basis in each store, distribution center and Home Depot Supply location to ensure that amounts reflected in the accompanying Consolidated Financial Statements for Merchandise Inventories are properly stated. During the period between physical inventory counts in stores, the Company accrues for estimated losses related to shrink on a store-by-store basis based on historical shrink results and current trends in the business. Shrink (or in the case of excess inventory, "swell") is the difference between the recorded amount of inventory and the physical inventory. Shrink may occur due to theft, loss, inaccurate records for the receipt of inventory or deterioration of goods, among other things.

**Income Taxes**

The Company provides for federal, state and foreign income taxes currently payable, as well as for those deferred due to timing differences between reporting income and expenses for financial statement purposes versus tax purposes. Federal, state and foreign tax benefits are recorded as a reduction of income taxes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases.

*(continued on the next page)*





## Appendix A Home Depot 2005 Financial Statements

A-9

Deferred tax assets and liabilities are measured using enacted income tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of a change in income tax rates is recognized as income or expense in the period that includes the enactment date.

The Company and its eligible subsidiaries file a consolidated U.S. federal income tax return. Non-U.S. subsidiaries and certain U.S. subsidiaries, which are consolidated for financial reporting purposes, are not eligible to be included in the Company's consolidated U.S. federal income tax return. Separate provisions for income taxes have been determined for these entities. The Company intends to reinvest the unremitted earnings of its non-U.S. subsidiaries and postpone their remittance indefinitely. Accordingly, no provision for U.S. income taxes for non-U.S. subsidiaries was recorded in the accompanying Consolidated Statements of Earnings.

The American Jobs Creation Act of 2004 ("AJC Act") provides a one-time 85% dividends-received deduction that applies to qualified cash dividends received from controlled foreign corporations if the funds are reinvested in the United States. The deduction can result in an effective income tax rate of 5.25% on the repatriation of foreign earnings, a rate much lower than the normal statutory tax rate of 35%. The Company has determined that it will not repatriate earnings of foreign subsidiaries under the AJC Act.

The AJC Act also provides a new deduction for qualified domestic production activities. When fully phased-in, the deduction will be up to 9% of the lesser of qualified production activities income or taxable income. Because this provision is targeted toward manufacturing activities, the Company does not expect to recognize a material benefit in the current or future tax years.

### Depreciation and Amortization

The Company's Buildings, Furniture, Fixtures and Equipment are depreciated using the straight-line method over the estimated useful lives of the assets. Leasehold Improvements are amortized using the straight-line method over the original term of the lease or the useful life of the improvement, whichever is shorter. The Company's Property and Equipment is depreciated using the following estimated useful lives:

	Life
Buildings	10-45 years
Furniture, Fixtures and Equipment	3-20 years
Leasehold Improvements	5-30 years

### Capitalized Software Costs

The Company capitalizes certain costs related to the acquisition and development of software and amortizes these costs using the straight-line method over the estimated useful life of the software, which is three to six years. These costs are included in Furniture, Fixtures and Equipment in the accompanying Consolidated Balance Sheets. Certain development costs not meeting the criteria for capitalization are expensed as incurred.

### Revenues

The Company recognizes revenue, net of estimated returns, at the time the customer takes possession of merchandise or receives services. The liability for sales returns is estimated based on historical return levels. When the Company receives payment from customers before the customer has taken possession of the merchandise or the service has been performed, the amount received is recorded as Deferred Revenue in the accompanying Consolidated Balance Sheets until the sale or service is complete. The Company also records Deferred Revenue for the sale of gift cards and recognizes this revenue upon the redemption of gift cards in Net Sales. Gift card breakage income is recognized based

*(continued on the next page)*



**A-10****Appendix A** Home Depot 2005 Financial Statements

upon historical redemption patterns and represents the balance of gift cards for which the Company believes the likelihood of redemption by the customer is remote. During fiscal 2005, the Company recognized \$52 million of gift card breakage income. Fiscal 2005 was the first year in which the Company recognized gift card breakage income, and therefore, the amount recognized includes the gift card breakage income related to gift cards sold since the inception of the gift card program. This income is recorded as other income and is included in the Consolidated Statement of Earnings as a reduction in Selling, General and Administrative Expenses ("SG&A").

**Services Revenue**

Net Sales include services revenue generated through a variety of installation and home maintenance programs. In these programs, the customer selects and purchases material for a project and the Company provides or arranges professional installation. These programs are offered through the Company's stores and focus primarily on providing products and services to do-it-for-me customers. The Company also arranges for the provision of flooring, countertop, cabinet and window covering installation services to production home builders through its Creative Touch Interiors brand. Under certain programs, when the Company provides or arranges the installation of a project and the subcontractor provides material as part of the installation, both the material and labor are included in services revenue. The Company recognizes this revenue when the service for the customer is complete.

All payments received prior to the completion of services are recorded in Deferred Revenue in the accompanying Consolidated Balance Sheets. Services revenue, including the impact of deferred revenue, was \$4.3 billion, \$3.6 billion and \$2.8 billion for fiscal 2005, 2004 and 2003, respectively.

**Self-Insurance**

The Company is self-insured for certain losses related to general liability, product liability, automobile, workers' compensation and medical claims. The expected ultimate cost for claims incurred as of the balance sheet date is not discounted and is recognized as a liability. The expected ultimate cost of claims is estimated based upon analysis of historical data and actuarial estimates.

**Prepaid Advertising**

Television and radio advertising production costs along with media placement costs are expensed when the advertisement first appears. Included in Other Current Assets in the accompanying Consolidated Balance Sheets are \$42 million and \$33 million, respectively, at the end of fiscal 2005 and 2004 relating to prepayments of production costs for print and broadcast advertising.

**Vendor Allowances**

The Company currently receives two types of vendor allowances: volume rebates that are earned as a result of attaining certain purchase levels and advertising co-op allowances for the promotion of vendors' products that are typically based on guaranteed minimum amounts with additional amounts being earned for attaining certain purchase levels. All vendor allowances are accrued as earned, and those allowances received as a result of attaining certain purchase levels are accrued over the incentive period based on estimates of purchases.

In fiscal 2003, the Company adopted Emerging Issues Task Force No. 02-16, "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor" ("EITF 02-16"), which states that cash consideration received from a vendor is presumed to be a reduction of the prices of the vendor's products or services and should, therefore, be characterized as a reduction of Cost of Sales when recognized in the Company's Consolidated Statements of Earnings. That presumption is overcome when the consideration is either a reimbursement of specific, incremental and identifiable costs incurred to sell the vendor's product or a payment for assets or services

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delivered to the vendor. The Company receives consideration in the form of advertising co-op allowances from its vendors pursuant to annual agreements, which are generally on a calendar year basis. As permitted by EITF 02-16, the Company elected to apply the provisions of EITF 02-16 prospectively to all agreements entered into or modified after December 31, 2002.

There was no material impact to the Company's Consolidated Statements of Earnings or Consolidated Balance Sheets for fiscal 2005. The impact of EITF 02-16 in fiscal 2004 and fiscal 2003 resulted in a reduction of Cost of Sales of \$891 million and \$40 million, an increase to SG&A of \$1.0 billion and \$47 million and a reduction to Earnings before Provision for Income Taxes of \$158 million and \$7 million, respectively. The impact on the Company's Diluted Earnings per Share was a reduction of \$0.04 in fiscal 2004. There was no material impact on the Company's Diluted Earnings per Share in fiscal 2003.

Volume rebates and advertising co-op allowances earned are initially recorded as a reduction in Merchandise Inventories and a subsequent reduction in Cost of Sales when the related product is sold. Prior to the adoption of EITF 02-16 in January 2004, advertising co-op allowances earned had been offset against advertising expense to the extent of advertising costs incurred, with the excess treated as a reduction of Cost of Sales.

The Company continues to earn certain advertising co-op allowances that are recorded as an offset against advertising expense as they are reimbursements of specific, incremental and identifiable costs incurred to promote vendors' products. In fiscal 2005, 2004 and 2003, net advertising expense was \$1.1 billion, \$1.0 billion and \$58 million, respectively, which was recorded in SG&A.

#### **Cost of Sales**

Cost of Sales includes the actual cost of merchandise sold and services performed, the cost of transportation of merchandise from vendors to the Company's stores, locations or customers, the operating cost of the Company's distribution centers and the cost of deferred interest programs offered through the Company's private label credit card program.

The cost of handling and shipping merchandise from the Company's stores, locations or distribution centers to the customer is classified as SG&A. The cost of shipping and handling, including internal costs and payments to third parties, classified as SG&A was \$563 million, \$499 million and \$387 million in fiscal 2005, 2004 and 2003, respectively.

#### **Cost in Excess of the Fair Value of Net Assets Acquired and Other Intangible Assets**

Goodwill represents the excess of purchase price over fair value of net assets acquired. The Company does not amortize goodwill, but does assess the recoverability of goodwill in the third quarter of each year by determining whether the fair value of each reporting unit supports its carrying value. The fair values of the Company's identified reporting units were estimated using the expected present value of discounted cash flows. The Company recorded no impairment charges for fiscal 2005, 2004 or 2003.

The Company amortizes the cost of other intangible assets over their estimated useful lives, which range from 1 to 12 years, unless such lives are deemed indefinite. Intangible assets with indefinite lives are tested in the third quarter of each year for impairment and written down to fair value as required. The Company recorded no impairment charges for fiscal 2005, 2004 or 2003.

#### **Impairment of Long-Lived Assets**

The Company evaluates the carrying value of long-lived assets when management makes the decision to relocate or close a store, or when circumstances indicate the carrying amount of an asset may not be recoverable. Losses related to the impairment of long-lived assets are recognized to the extent the sum of undiscounted estimated future cash flows expected to result from the use of the asset are less than

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## A-12

## Appendix A Home Depot 2005 Financial Statements

the asset's carrying value. If the carrying value is greater than the future cash flows, a provision is made to write down the related assets to the estimated net recoverable value. Impairment losses were recorded as a component of SG&A in the accompanying Consolidated Statements of Earnings. When a location closes, the Company also recognizes in SG&A the net present value of future lease obligations, less estimated sublease income.

In fiscal 2005, the Company closed 20 of its EXPO stores, four of which are being converted to The Home Depot store format. In fiscal 2005, the Company charged \$91 million to SG&A related to the dispositions, of which \$78 million was for asset impairment charges and \$13 million was for lease obligations. The Company remains contingently liable for future minimum lease payments related to the affected stores, for which the amounts are not material. Additionally, the Company incurred \$29 million of expense in Cost of Sales in fiscal 2005 related to inventory markdowns in these stores. Affected customers are being served by existing The Home Depot and EXPO stores. In fiscal 2005, the Company also closed two Home Depot Supply stores which did not have a material impact to the Company's financial results.

### Stock-Based Compensation

Effective February 3, 2003, the Company adopted the fair value method of recording stock-based compensation expense in accordance with SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"). The Company selected the prospective method of adoption as described in SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure" and accordingly, stock-based compensation expense was recognized related to stock options granted, modified or settled and expense related to the Employee Stock Purchase Plan ("ESPP") after the beginning of fiscal 2003. The fair value of stock options and ESPP as determined on the date of grant using the Black-Scholes option-pricing model is being expensed over the vesting period of the related stock options and ESPP. Prior to February 3, 2003, the Company elected to account for its stock-based compensation plans under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), which requires the recording of stock-based compensation expense for some, but not all, stock-based compensation.

The per share weighted average fair value of stock options granted during fiscal 2005, 2004 and 2003 was \$12.83, \$13.57 and \$9.79, respectively. The fair value of these options was determined at the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	Fiscal Year Ended		
	January 29, 2006	January 30, 2005	February 1, 2004
Risk-free interest rate	4.3%	2.6%	3.0%
Assumed volatility	33.7%	41.3%	44.6%
Assumed dividend yield	1.1%	0.8%	1.0%
Assumed lives of option	5 years	5 years	5 years

## Appendix A Home Depot 2005 Financial Statements

A-13

The following table illustrates the effect on Net Earnings and Earnings per Share as if the Company had applied the fair value recognition provisions of SFAS 123 to all stock-based compensation in each period (amounts in millions, except per share data):

	Fiscal Year Ended		
	January 29, 2006	January 30, 2005	February 1, 2004
Net Earnings, as reported	\$ 5,838	\$ 5,001	\$ 4,304
Add: Stock-based compensation expense included in reported Net Earnings, net of related tax effects	110	79	42
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects	(197)	(237)	(279)
Pro forma net earnings	\$ 5,751	\$ 4,843	\$ 4,067
<b>Earnings per Share:</b>			
Basic – as reported	\$ 2.73	\$ 2.27	\$ 1.88
Basic – pro forma	\$ 2.69	\$ 2.19	\$ 1.78
Diluted – as reported	\$ 2.72	\$ 2.26	\$ 1.88
Diluted – pro forma	\$ 2.68	\$ 2.19	\$ 1.78

In April 2005, the Securities and Exchange Commission issued guidance delaying the effective date of SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123(R)"), therefore it will now be effective for The Home Depot in the first quarter of fiscal 2006. The Company intends to adopt SFAS 123(R) using the modified-prospective method, therefore, in addition to continuing to recognize stock-based compensation expense for all share-based payments awarded since the adoption of SFAS 123 in fiscal 2003, the Company will also begin expensing unvested options granted prior to 2003 upon the adoption of SFAS 123(R). The Company currently estimates the impact of adopting SFAS 123(R) will be a reduction of Earnings before Provision for Income Taxes of approximately \$40 million for fiscal 2006.

### Derivatives

The Company measures its derivatives at fair value and recognizes these assets or liabilities on the Consolidated Balance Sheets. The Company's primary objective for entering into derivative instruments is to manage its exposure to interest rate fluctuations, as well as to maintain an appropriate mix of fixed and variable rate debt. At January 29, 2006, the Company had several outstanding interest rate swaps, accounted for as fair value hedges, with a notional amount of \$475 million that swap fixed rate interest on the Company's \$500 million 5<sup>3</sup>/<sub>8</sub>% Senior Notes for variable interest rates equal to LIBOR plus 30 to 245 basis points and expire on April 1, 2006. At January 29, 2006, the fair market value of these agreements was a liability of \$1 million, which is the estimated amount that the Company would have paid to settle similar interest rate swap agreements at current interest rates.

### Comprehensive Income

Comprehensive Income includes Net Earnings adjusted for certain revenues, expenses, gains and losses that are excluded from Net Earnings under generally accepted accounting principles. Adjustments to Net Earnings are primarily for foreign currency translation adjustments.

### Foreign Currency Translation

Assets and Liabilities denominated in a foreign currency are translated into U.S. dollars at the current rate of exchange on the last day of the reporting period. Revenues and Expenses are generally translated at a daily exchange rate and equity transactions are translated using the actual rate on the day of the transaction.

### Segment Information

The Company operates within a single operating segment within North America. Net Sales for Canada and Mexico were \$5.3 billion, \$4.2 billion and \$3.4 billion during fiscal 2005, 2004 and 2003, respectively. Long-lived assets in Canada and Mexico totaled \$2.2 billion and \$1.7 billion as of January 29, 2006 and January 30, 2005, respectively.

### Reclassifications

Certain amounts in prior fiscal years have been reclassified to conform with the presentation adopted in the current fiscal year.

## A-14

## Appendix A Home Depot 2005 Financial Statements

**10-Year Summary of Financial and Operating Results  
The Home Depot, Inc. and Subsidiaries**
*amounts in millions, except where noted*

	10-Year Compound Annual Growth Rate	2005	2004
<b>STATEMENT OF EARNINGS DATA</b>			
Net sales	18.1%	\$ 81,511	\$ 73,094
Net sales increase (%)	—	11.5	12.8
Earnings before provision for income taxes	22.8	9,282	7,912
Net earnings	23.1	5,838	5,001
Net earnings increase (%)	—	16.7	16.2
Diluted earnings per share (\$) <sup>(2)</sup>	23.1	2.72	2.26
Diluted earnings per share increase (%)	—	20.4	20.2
Diluted weighted average number of common shares	—	2,147	2,216
Gross margin – % of sales	—	33.5	33.4
Total operating expenses – % of sales	—	22.0	22.6
Net interest income (expense) – % of sales	—	(0.1)	—
Earnings before provision for income taxes – % of sales	—	11.4	10.8
Net earnings – % of sales	—	7.2	6.8
<b>BALANCE SHEET DATA AND FINANCIAL RATIOS</b>			
Total assets	19.7%	\$ 44,482	\$ 39,020
Working capital	6.9	2,445	3,818
Merchandise inventories	18.0	11,401	10,076
Net property and equipment	18.8	24,901	22,726
Long-term debt	14.0	2,672	2,148
Stockholders' equity	18.4	26,909	24,158
Book value per share (\$) <sup>(2)</sup>	18.5	12.67	11.06
Long-term debt-to-equity (%)	—	9.9	8.9
Total debt-to-equity (%)	—	15.2	8.9
Current ratio	—	1.19:1	1.37:1
Inventory turnover	—	4.8x	4.9x
Return on invested capital (%)	—	22.4	21.5
<b>STATEMENT OF CASH FLOWS DATA</b>			
Depreciation and amortization	24.2%	\$ 1,579	\$ 1,319
Capital expenditures <sup>(3)</sup>	11.5	3,881	3,948
Cash dividends per share (\$) <sup>(3)</sup>	25.3	0.400	0.325
<b>STORE DATA <sup>(4)</sup></b>			
Number of stores	17.1%	2,042	1,890
Square footage at fiscal year-end	17.2	215	201
Increase in square footage (%)	—	7.0	9.8
Average square footage per store (in thousands)	—	105	106
<b>STORE SALES AND OTHER DATA</b>			
Comparable store sales increase (%) <sup>(5)(6)(7)</sup>	—	3.8	5.4
Weighted average weekly sales per operating store (in thousands)	(0.3)%	\$ 763	\$ 766
Weighted average sales per square foot (\$) <sup>(4)(5)</sup>	(0.3)	377	375
Number of customer transactions <sup>(4)</sup>	13.6	1,330	1,295
Average ticket (\$) <sup>(4)</sup>	3.3	57.98	54.89
Number of associates at fiscal year-end	15.6	344,810	323,149

(1) Fiscal years 2001 and 1996 include 53 weeks; all other fiscal years reported include 52 weeks.

(2) Diluted earnings per share for fiscal 1997, excluding a \$104 million non-recurring charge, were \$0.55.

(3) Excludes payments for businesses acquired (net, in millions) for fiscal years 2005 (\$2,546), 2004 (\$727), 2003 (\$215), 2002 (\$235), 2001 (\$190), 2000 (\$26), 1999 (\$101), 1998 (\$6) and 1997 (\$61).

(4) Excludes all non-store locations since their inclusion may cause distortion of the data presented due to operational differences from our retail stores. The total number of the excluded locations and their total square footage are immaterial to our total number of locations and total square footage.

(5) Adjusted to reflect the first 52 weeks of the 53-week fiscal years in 2001 and 1996.

## Appendix A Home Depot 2005 Financial Statements

A-15

	2003	2002	2001 <sup>(1)</sup>	2000	1999	1998	1997	1996 <sup>(1)</sup>
<b>STATEMENT OF EARNINGS DATA</b>								
Net sales	\$ 64,816	\$ 58,247	\$ 53,553	\$ 45,738	\$ 38,434	\$ 30,219	\$ 24,156	\$ 19,535
Net sales increase (%)	11.3	8.8	17.1	19.0	27.2	25.1	23.7	26.3
Earnings before provision for income taxes	6,843	5,872	4,957	4,217	3,804	2,654	1,898	1,535
Net earnings	4,304	3,664	3,044	2,581	2,320	1,614	1,160	938
Net earnings increase (%)	17.5	20.4	17.9	11.3	43.7	31.9	23.7	28.2
Diluted earnings per share (\$) <sup>(2)</sup>	1.88	1.56	1.29	1.10	1.00	0.71	0.52	0.43
Diluted earnings per share increase (%)	20.5	20.9	17.3	10.0	40.8	29.1	20.9	26.5
Diluted weighted average number of common shares	2,289	2,344	2,353	2,352	2,342	2,320	2,287	2,195
Gross margin – % of sales	31.8	31.1	30.2	29.9	29.7	28.5	28.1	27.8
Total operating expenses – % of sales	21.2	21.1	20.9	20.7	19.8	19.7	19.8	20.0
Net interest income (expense) – % of sales	—	0.1	—	—	—	—	—	0.1
Earnings before provision for income taxes – % of sales	10.6	10.1	9.3	9.2	9.9	8.8	7.9	7.9
Net earnings – % of sales	6.6	6.3	5.7	5.6	6.0	5.3	4.8	4.8
<b>BALANCE SHEET DATA AND FINANCIAL RATIOS</b>								
Total assets	\$ 34,437	\$ 30,011	\$ 26,394	\$ 21,385	\$ 17,081	\$ 13,465	\$ 11,229	\$ 9,342
Working capital	3,774	3,882	3,860	3,392	2,734	2,076	2,004	1,867
Merchandise inventories	9,076	8,338	6,725	6,556	5,489	4,293	3,602	2,708
Net property and equipment	20,063	17,168	15,375	13,068	10,227	8,160	6,509	5,437
Long-term debt	856	1,321	1,250	1,545	750	1,566	1,303	1,247
Stockholders' equity	22,407	19,802	18,082	15,004	12,341	8,740	7,098	5,955
Book value per share (\$)	9.93	8.38	7.71	6.46	5.36	3.95	3.23	2.75
Long-term debt-to-equity (%)	3.8	6.7	6.9	10.3	6.1	17.9	18.4	20.9
Total debt-to-equity (%)	6.1	6.7	6.9	10.3	6.1	17.9	18.4	20.9
Current ratio	1.40:1	1.48:1	1.59:1	1.77:1	1.75:1	1.73:1	1.82:1	2.01:1
Inventory turnover	5.0x	5.3x	5.4x	5.1x	5.4x	5.4x	5.4x	5.6x
Return on invested capital (%)	20.4	18.8	18.3	19.6	22.5	19.3	16.1	16.3
<b>STATEMENT OF CASH FLOWS DATA</b>								
Depreciation and amortization	\$ 1,076	\$ 903	\$ 764	\$ 601	\$ 463	\$ 373	\$ 283	\$ 232
Capital expenditures <sup>(3)</sup>	3,508	2,749	3,393	3,574	2,618	2,094	1,464	1,248
Cash dividends per share (\$)	0.26	0.21	0.17	0.16	0.11	0.08	0.06	0.05
<b>STORE DATA<sup>(4)</sup></b>								
Number of stores	1,707	1,532	1,333	1,134	930	761	624	512
Square footage at fiscal year-end	183	166	146	123	100	81	66	54
Increase in square footage (%)	10.2	14.1	18.5	22.6	23.5	22.8	23.1	21.6
Average square footage per store (in thousands)	107	108	109	108	108	107	106	105
<b>STORE SALES AND OTHER DATA</b>								
Comparable store sales increase (%) <sup>(5)(6)(7)</sup>	3.8	—	—	4	10	7	7	7
Weighted average weekly sales per operating store (in thousands)	\$ 763	\$ 772	\$ 812	\$ 864	\$ 876	\$ 844	\$ 829	\$ 803
Weighted average sales per square foot (\$) <sup>(4)(5)</sup>	371	370	388	415	423	410	406	398
Number of customer transactions <sup>(4)</sup>	1,246	1,161	1,091	937	797	665	550	464
Average ticket (\$) <sup>(4)</sup>	51.15	49.43	48.64	48.65	47.87	45.05	43.63	42.09
Number of associates at fiscal year-end	298,800	280,900	256,300	227,300	201,400	156,700	124,400	98,100

(6) Includes Net Sales at locations open greater than 12 months, including relocated and remodeled stores, and Net Sales of all the subsidiaries of The Home Depot, Inc. Stores and subsidiaries became comparable on the Monday following their 365<sup>th</sup> day of operation and include certain locations acquired in the current year by existing subsidiaries. Comparable store sales is intended only as supplemental information and is not a substitute for Net Sales or Net Earnings presented in accordance with generally accepted accounting principles.

(7) Beginning in fiscal 2003, comparable store sales increases were reported to the nearest one-tenth of a percentage. Comparable store sales increases in fiscal years prior to 2003 were not adjusted to reflect this change.