

ROSS STORES INC  
Form 10-Q  
September 12, 2007

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

**FORM 10-Q**

(Mark one)

X

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

**For the quarterly period ended August 4, 2007**

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 0-14678

**Ross Stores, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or  
organization)

**94-1390387**

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

**4440 Rosewood Drive, Pleasanton, California**

(Address of principal executive offices)

**94588-3050**

(Zip Code)

Registrant's telephone number, including area code

**(925) 965-4400**

Former name, former address and former fiscal year, if  
changed since last report.

N/A

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  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  Accelerated filer  Non-accelerated filer

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
 Yes \_\_\_\_\_ No  X

The number of shares of Common Stock, with \$.01 par value, outstanding on August 23, 2007 was 137,116,311.

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**PART I. FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**Condensed Consolidated Statements of Earnings**

(\$000, except per share data, unaudited)	Three Months Ended		Six Months Ended	
	August 4, 2007	July 29, 2006	August 4, 2007	July 29, 2006
<b>Sales</b>	<b>\$ 1,444,632</b>	\$ 1,308,052	<b>\$ 2,855,173</b>	\$ 2,599,728
<b>Costs and expenses</b>				
Cost of goods sold	<b>1,131,286</b>	1,024,130	<b>2,202,564</b>	2,012,966
Selling, general and administrative	<b>229,326</b>	210,635	<b>459,529</b>	417,802
Interest (income) expense, net	<b>65</b>	(1,554)	<b>(1,326)</b>	(3,438)
Total costs and expenses	<b>1,360,677</b>	1,233,211	<b>2,660,767</b>	2,427,330
Earnings before taxes	<b>83,955</b>	74,841	<b>194,406</b>	172,398
Provision for taxes on earnings	<b>33,092</b>	29,464	<b>76,499</b>	67,804
Net earnings	<b>\$ 50,863</b>	\$ 45,377	<b>\$ 117,907</b>	\$ 104,594
<b>Earnings per share</b>				
Basic	<b>\$ .37</b>	\$ .32	<b>\$ .86</b>	\$ .74
Diluted	<b>\$ .37</b>	\$ .32	<b>\$ .85</b>	\$ .73
<b>Weighted average shares outstanding (000)</b>				
Basic	<b>136,052</b>	140,348	<b>136,569</b>	140,991
Diluted	<b>138,280</b>	142,698	<b>138,992</b>	143,454
<b>Dividends per share</b>				
Cash dividends declared per share	<b>\$ .08</b>	\$ .06	<b>\$ .08</b>	\$ .06
Stores open at end of period	<b>862</b>	770	<b>862</b>	770

See notes to condensed consolidated financial statements.

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**Condensed Consolidated Balance Sheets**

August 4,                      February 3,                      July 29,

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(\$000, unaudited)	2007	2007 (Note A)	2006
<b>Assets</b>			
<b>Current Assets</b>			
Cash and cash equivalents	\$ 132,808	\$ 367,388	\$ 59,351
Short-term investments	31,263	5,247	7,417
Accounts receivable	42,071	30,105	33,904
Merchandise inventory	1,070,376	1,051,729	959,792
Prepaid expenses and other	70,396	44,245	50,567
Deferred income taxes	30,942	16,242	20,014
Total current assets	1,377,856	1,514,956	1,131,045
<b>Property and Equipment</b>			
Land and buildings	143,513	134,804	138,036
Fixtures and equipment	900,922	859,750	794,591
Leasehold improvements	435,732	402,921	386,320
Construction-in-progress	35,040	22,681	33,185
	1,515,207	1,420,156	1,352,132
Less accumulated depreciation and amortization	724,909	671,923	618,227
Property and equipment, net	790,298	748,233	733,905
Other long-term assets	68,249	64,266	58,057
Long-term investments	32,476	31,136	13,140
Total assets	\$ 2,268,879	\$ 2,358,591	\$ 1,936,147
<b>Liabilities and Stockholders' Equity</b>			
<b>Current Liabilities</b>			
Accounts payable	\$ 598,953	\$ 698,063	\$ 537,928
Accrued expenses and other	206,351	206,516	191,581
Accrued payroll and benefits	125,485	145,101	131,082
Income taxes payable	-	33,577	-
Total current liabilities	930,789	1,083,257	860,591
Long-term debt	150,000	150,000	-
Other long-term liabilities	169,045	129,303	123,760
Deferred income taxes	81,997	86,201	94,747
Commitments and contingencies			
<b>Stockholders' Equity</b>			
Common stock	1,373	1,402	1,421
Additional paid-in capital	567,053	545,702	510,143
Treasury stock	(24,941)	(22,031)	(20,596)
Accumulated other comprehensive income	(108)	(163)	(173)
Retained earnings	393,671	384,920	366,254
Total stockholders' equity	937,048	909,830	857,049
Total liabilities and stockholders' equity	\$ 2,268,879	\$ 2,358,591	\$ 1,936,147

See notes to condensed consolidated financial statements.

**Condensed Consolidated Statements of Cash Flows**

(\$000, unaudited)	<b>Six Months Ended</b>	
	<b>August 4, 2007</b>	July 29, 2006
<b>Cash Flows From Operating Activities</b>		
Net earnings	\$ 117,907	\$ 104,594
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	58,006	50,915
Stock-based compensation	13,049	13,621
Deferred income taxes	(18,905)	(3,092)
Tax benefit from equity issuance	5,505	6,280
Excess tax benefits from stock-based compensation	(4,533)	(1,243)
Change in assets and liabilities:		
Merchandise inventory	(18,647)	(21,701)
Other current assets, net	(38,117)	(18,259)
Accounts payable	(88,665)	71,954
Other current liabilities	(46,917)	(36,743)
Other, net	28,965	2,770
Net cash provided by operating activities	7,648	169,096
<b>Cash Flows From Investing Activities</b>		
Purchase of assets under lease	-	(87,329)
Additions to property and equipment	(107,285)	(58,794)
Purchases of investments	(46,918)	(47,550)
Proceeds from investments	19,618	50,765
Net cash used in investing activities	(134,585)	(142,908)
<b>Cash Flows From Financing Activities</b>		
Payment of term debt	-	(50,000)
Issuance of common stock related to stock plans	11,861	8,550
Excess tax benefits from stock-based compensation	4,533	1,243
Treasury stock purchased	(2,919)	(2,352)
Repurchase of common stock	(100,578)	(98,867)
Dividends paid	(20,540)	(17,178)
Net cash used in financing activities	(107,643)	(158,604)
Net decrease in cash and cash equivalents	(234,580)	(132,416)
Cash and cash equivalents:		
Beginning of period	367,388	191,767
End of period	\$ 132,808	\$ 59,351
<b>Supplemental Cash Flow Disclosures</b>		
Interest paid	\$ 4,834	\$ 759

Income taxes paid	\$ 119,628	\$ 102,642
<b>Non-Cash Investing Activities</b>		
Change in fair value of investment securities	\$ 55	\$ (192)

See notes to condensed consolidated financial statements.

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## Notes to Interim Condensed Consolidated Financial Statements

Three and Six Months Ended August 4, 2007 and July 29, 2006  
(Unaudited)

### Note A: Summary of Significant Accounting Policies

**Basis of Presentation.** The accompanying unaudited interim condensed consolidated financial statements have been prepared from the records of Ross Stores, Inc. and subsidiaries (the "Company") without audit and, in the opinion of management, include all adjustments (consisting of only normal, recurring adjustments) necessary to present fairly the Company's financial position as of August 4, 2007 and July 29, 2006, the results of operations for the three and six months ended August 4, 2007 and July 29, 2006, and cash flows for the six months ended August 4, 2007 and July 29, 2006. The Condensed Consolidated Balance Sheet as of February 3, 2007, presented herein, has been derived from the Company's audited consolidated financial statements for the fiscal year then ended.

Accounting policies followed by the Company are described in Note A to the audited consolidated financial statements for the fiscal year ended February 3, 2007. Certain information and disclosures normally included in the notes to annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted for purposes of the interim condensed consolidated financial statements. The interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements, including notes thereto, contained in the Company's Annual Report on Form 10-K for the year ended February 3, 2007.

The results of operations for the three and six-month periods ended August 4, 2007 and July 29, 2006 herein presented are not necessarily indicative of the results to be expected for the full fiscal year.

**Total comprehensive income.** The components of total comprehensive income for the three and six-month periods ended August 4, 2007 and July 29, 2006 are as follows (in \$000):

	Three Months Ended		Six Months Ended	
	August 4, 2007	July 29, 2006	August 4, 2007	July 29, 2006
Net income	\$ 50,863	\$ 45,377	\$ 117,907	\$ 104,594
Unrealized (loss) gain on investments, net of taxes	(105)	(45)	33	(167)
<b>Total comprehensive income</b>	<b>\$ 50,758</b>	<b>\$ 45,332</b>	<b>\$ 117,940</b>	<b>\$ 104,427</b>

**FIN 48.** Effective in fiscal year 2007, the Company adopted the Financial Accounting Standards Board ("FASB") Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement 109" ("FIN 48"). This interpretation prescribes a recognition threshold of more-likely-than-not and a measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. See Note E for more information on the Company's adoption of FIN 48.

**Stock-based compensation.** Effective in fiscal year 2006, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 123(R), "Share-Based Payment," using the modified prospective transition method.

This accounting standard requires recognition of compensation expense based upon the grant date fair value of all stock-based awards, typically over the vesting period. See Note B for more information on the Company's stock-based compensation plans.

**Dividends.** Dividends included in the Condensed Consolidated Statements of Cash Flows reflect actual dividends paid during the periods shown. Dividends per share reported in the Condensed Consolidated Statements of Earnings reflects dividends declared during the period shown. In January and May of 2007, the Company's Board of Directors declared a quarterly cash dividend of \$.075 per common share, paid in March and July of 2007, respectively. The Company's Board of Directors declared quarterly cash dividends of \$.06 per common share in January, May, August, and November 2006.

In August 2007, the Company's Board of Directors declared a cash dividend payment of \$.075 per common share, payable on or about October 1, 2007.

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**Provision for litigation expense and other legal proceedings.** Like many California retailers, the Company has been named in class action lawsuits regarding wage and hour claims. In February 2007, the Orange County Superior Court approved a settlement of the cases involving whether the Company's assistant store managers in California are correctly classified as exempt under California Wage Orders. The approved settlement obligation was paid during the quarter ended May 5, 2007.

Other class action litigation involving allegations that hourly associates have missed meal and/or rest break periods, as well as allegations of unpaid overtime wages to assistant store managers at all Company stores under federal law, remains pending as of August 4, 2007. Resolution of this matter is not expected to have a material adverse effect on the Company's financial condition or results of operations.

The Company is also party in various other legal proceedings arising in the normal course of business. Actions filed against the Company include commercial, customer, and labor and employment-related claims, including lawsuits in which plaintiffs allege that the Company violated state and/or federal wage and hour and related laws. Actions against the Company are in various procedural stages. Many of these proceedings raise factual and legal issues and are subject to uncertainties. In the opinion of management, resolution of these matters is not expected to have a material adverse effect on the Company's financial condition or results of operations.

#### **Note B: Stock-Based Compensation**

**Stock options and restricted stock.** The Company has one equity incentive compensation plan, the 2004 Equity Incentive Plan (the "2004 Plan"). The 2004 Plan provides for various types of incentive awards, which may potentially include the grant of non-qualified and incentive stock options, stock appreciation rights, restricted stock purchase rights, restricted stock shares, restricted stock units, performance shares, performance units and deferred stock units. The 2004 Plan also provides for the automatic grant of stock options to each non-employee director at pre-established times and at a predetermined formula to determine the number of shares subject to stock options. Under the 2004 Plan, stock options are granted at exercise prices not less than the fair market value on the date the option is granted, expire not more than ten years from the date of grant, and normally vest over a period not exceeding five years from the date of grant.

**Restricted stock.** The Company grants restricted shares to officers and key employees. The fair value of these shares at the date of grant is expensed on a straight-line basis over the vesting period of generally two to five years. During the six-month period ended August 4, 2007, restricted stock awards totaling 451,000 shares were issued and awards totaling 29,000 shares were forfeited. The aggregate unamortized compensation expense at August 4, 2007 was \$34.5 million. During the period, shares withheld for tax withholding totaled 88,000 shares, and are considered treasury shares which are available for reissuance. As of August 4, 2007, shares subject to repurchase related to unvested restricted stock totaled 2.1 million shares. A total of 2.8 million shares were available for future restricted stock awards under the 2004 Plan as of August 4, 2007.

**Performance shares.** Beginning in fiscal 2007, the Company initiated a performance share award program for senior executives. The performance share program represents a right to receive shares of common stock on a specified settlement date if the performance share vests based on the Company's attainment of a profitability-based performance goal during a performance period.

**Employee stock purchase plan.** Under the Employee Stock Purchase Plan ("ESPP"), eligible full-time employees participating in the offering period can choose to have up to the lesser of 10% or \$21,250 of their annual base earnings withheld to purchase the Company's common stock. The purchase price of the stock is the lower of 85% of the market price at the beginning of the offering period or end of the offering period.

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**Stock-based compensation.** For the three and six-month periods ended August 4, 2007 and July 29, 2006, the Company recognized stock-based compensation expense as follows (in \$000):

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>August 4, 2007</b>	July 29, 2006	<b>August 4, 2007</b>	July 29, 2006
Stock options and ESPP	\$ 2,496	\$ 3,308	\$ 4,909	\$ 6,772
Restricted stock and performance shares	4,183	3,408	8,140	6,849
Total	\$ 6,679	\$ 6,716	\$ 13,049	\$ 13,621

Capitalized stock-based compensation cost was not significant.

The determination of the fair value of stock options and ESPP shares, using the Black-Scholes model, is affected by the Company's stock price as well as assumptions as to the Company's expected stock price volatility over the term of the awards, actual and projected employee stock option exercise behavior, the risk-free interest rate, and expected dividends.

The Company estimates the expected term of options granted taking into account historical and expected future exercise, cancellation and forfeiture behavior. The Company estimates the volatility of the common stock by using historical volatility over a period equal to the award's expected term. The risk-free interest rates used in the valuation models are based upon yields of U.S. Treasury issues with remaining terms similar to the expected term of the options. Dividend yield has been estimated based on the Company's expectation as to future dividend payouts.

The Company uses historical data to estimate pre-vesting forfeiture rates in determining the amount of stock-based compensation expense to recognize. All stock-based compensation awards are amortized on a straight-line basis over the requisite service periods of the awards.

The fair value of stock options and ESPP rights granted during the respective periods were estimated using the following assumptions:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>August 4, 2007</b>	July 29, 2006	<b>August 4, 2007</b>	July 29, 2006
<b>Stock Options</b>				
Expected life from grant date (years)	3.8	3.9	3.9	4.2
Expected volatility	27.7%	31.4%	28.4%	32.7%
Risk-free interest rate	4.7%	4.9%	4.7%	4.5%
Dividend yield	1.0%	0.8%	0.9%	0.8%
<b>Employee Stock Purchase Plan</b>				
Expected life from grant date (years)	0.5	0.5	1.0	2.0
Expected volatility	21.2%	26.6%	26.4%	26.4%
Risk-free interest rate	5.0%	4.5%	5.0%	4.5%
Dividend yield	0.9%	0.8%	0.9%	0.8%

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Total stock-based compensation recognized in the Company's Condensed Consolidated Statements of Earnings for the periods ended August 4, 2007 and July 29, 2006 is as follows (in \$000):

Statements of Earnings Classification	Three Months Ended		Six Months Ended	
	August 4, 2007	July 29, 2006	August 4, 2007	July 29, 2006
Cost of goods sold	\$ 2,730	\$ 2,919	\$ 5,579	\$ 5,872
Selling, general and administrative	3,949	3,797	7,470	7,749
<b>Total</b>	<b>\$ 6,679</b>	<b>\$ 6,716</b>	<b>\$ 13,049</b>	<b>\$ 13,621</b>

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The weighted average fair values per share of stock options granted for the three-month periods ended August 4, 2007 and July 29, 2006, were \$8.50 and \$8.37, and for the six-month periods ended August 4, 2007 and July 29, 2006, were \$9.18 and \$8.66, respectively. The weighted average fair values per share of employee stock purchase awards for the three-month periods ended August 4, 2007 and July 29, 2006, were \$6.62 and \$6.11, and for the six-month periods ended August 4, 2007 and July 29, 2006, were \$8.02 and \$7.70, respectively.

**Stock option activity.** The following table summarizes stock option activity for the six months ended August 4, 2007:

(000, except per share data)	Number of shares	Weighted average exercise price	Weighted average remaining contractual term	Aggregate intrinsic value
Outstanding at February 3, 2007	7,227	\$ 22.47		
Granted	580	\$ 34.21		
Exercised	(722)	\$ 16.43		
Forfeited	(126)	\$ 27.21		
<b>Outstanding at August 4, 2007</b>	<b>6,959</b>	<b>\$ 23.99</b>	<b>6.28</b>	<b>\$ 31,796</b>
<b>Vested or Expected to Vest at August 4, 2007</b>	<b>6,797</b>	<b>\$ 23.84</b>	<b>6.23</b>	<b>\$ 31,751</b>
<b>Exercisable at August 4, 2007</b>	<b>4,531</b>	<b>\$ 21.08</b>	<b>5.19</b>	<b>\$ 31,079</b>

The following table summarizes information about the weighted average remaining contractual life (in years) and the weighted average exercise price for stock options both outstanding and exercisable as of August 4, 2007 (number of shares in thousands):

Exercise price range	Options outstanding			Options exercisable	
	Number of shares	Remaining life	Exercise price	Number of shares	Exercise price
\$ 6.69 to \$ 18.89	1,540	2.63	\$ 12.37	1,540	\$ 12.37
18.90 to 26.47	1,451	6.02	21.93	1,246	21.52
26.50 to 28.35	1,471	7.72	27.69	811	27.67
28.36 to 29.14	1,400	7.49	28.64	545	28.66
\$ 29.17 to \$ 34.37	1,097	8.26	32.12	389	29.77



<b>Totals</b>	6,959	6.28	\$ 23.99	4,531	\$ 21.08
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**Note C: Earnings Per Share**

SFAS No. 128, "Earnings Per Share," requires both basic and diluted earnings per share ("EPS") to be computed and reported. Basic EPS is computed by dividing net earnings by the weighted average number of common shares outstanding for the period. Diluted EPS is computed by dividing net earnings by the sum of the weighted average number of common shares and dilutive common stock equivalents outstanding during the period. Dilutive EPS reflects the potential dilution that could occur if outstanding options to issue common stock were exercised into common stock.

For the three and six month periods ended August 4, 2007, there were approximately 810,000 and 554,200 shares, respectively, that could potentially dilute basic EPS in the future that were excluded from the calculation of diluted EPS because their effect would have been anti-dilutive in the periods presented. For the three and six-month periods ended July 29, 2006, there were approximately 3,857,600 and 3,641,500 shares, respectively, that could potentially dilute basic EPS in the future that were excluded from the calculation of diluted EPS because their effect would have been anti-dilutive in the periods presented.

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The following is a reconciliation of the number of shares (denominator) used in the basic and diluted EPS computations (shares in thousands):

	Three Months Ended			Six Months Ended		
	Basic EPS	Effect of Dilutive Common Stock Equivalents	Diluted EPS	Basic EPS	Effect of Dilutive Common Stock Equivalents	Diluted EPS
<b>August 4, 2007</b>						
Shares	136,052	2,228	138,280	136,569	2,423	138,992
Amount	\$ .37	\$ .00	\$ .37	\$ .86	(\$ .01)	\$ .85
<b>July 29, 2006</b>						
Shares	140,348	2,350	142,698	140,991	2,463	143,454
Amount	\$ .32	\$ .00	\$ .32	\$ .74	(\$ .01)	\$ .73

**Note D: Debt and Revolving Credit**

In July 2006, the Company amended its existing \$600.0 million revolving credit facility, extending the expiration date to July 2011, and changing the interest pricing to LIBOR plus 45 basis points.

In October 2006, the Company entered into a Note Purchase Agreement with various institutional investors for \$150.0 million of unsecured, senior notes. The notes were issued in two series and funding occurred in December 2006. The series A notes were issued for an aggregate of \$85.0 million, are due in December 2018, and bear interest at a rate of 6.38%. The series B notes were issued for an aggregate of \$65.0 million, are due in December 2021, and bear interest at a rate of 6.53%. Borrowings under these notes are subject to certain operating and financial covenants including maintaining certain interest coverage and leverage ratios. As of August 4, 2007, the Company was in compliance with these covenants.

**Note E: Income Taxes**

In June 2006, the FASB issued FIN 48. This statement clarifies the criteria that an individual tax position must satisfy for some or all of the benefits of that position to be recognized in a company's consolidated financial statements. FIN 48 prescribes a recognition threshold of more-likely-than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the consolidated financial statements.

Effective February 4, 2007, the Company adopted the provisions of FIN 48. As a result, the Company established a \$26.3 million reserve for unrecognized tax benefits, inclusive of \$6.0 million of related interest. The reserve is classified as a long-term liability and included in other long-term liabilities on the Company's condensed consolidated balance sheet. Upon adoption of FIN 48, the Company also recognized a reduction in retained earnings of \$7.4 million and certain other deferred income tax assets and liabilities were reclassified.

As of August 4, 2007, the reserve for unrecognized tax benefits increased to \$28.3 million inclusive of \$7.1 million of related interest. The Company accounts for interest related to unrecognized tax benefits as a part of its provision for taxes on earnings. If recognized, \$16.8 million would impact the Company's effective tax rate. The difference between the total amount of unrecognized tax benefits and the amounts that would impact the effective tax rate relates to amounts attributable to deferred income tax assets and liabilities. These amounts are net of federal and state income taxes.

During the next twelve months, it is reasonably possible that the Company will receive guidance from the Internal Revenue Service, or the statute of limitations may lapse pertaining to positions taken by the Company in prior year tax returns. As a result, the total amount of unrecognized tax benefits may decrease, which would reduce the provision for taxes on earnings by up to \$3.6 million, net of federal tax benefits.

The Company is currently open to audit by the Internal Revenue Service under the statute of limitations for fiscal years 2004 through 2006. The Company's state income tax returns are open to audit under the statute of limitations for the fiscal years 2003 through 2006. Certain state tax returns are currently under audit by the state tax authorities. The Company does not expect the result of these audits to have a material impact on the consolidated financial statements.

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**Note F: Recently Issued Accounting Standards**

SFAS No. 157, "Fair Value Measurements" (SFAS No. 157) is effective for fiscal years beginning after November 15, 2007. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands required disclosures regarding fair value measurements. The Company does not believe the adoption of SFAS No. 157 will have a material impact on its operating results or financial position.

SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS 159) is effective for fiscal years beginning after November 15, 2007. SFAS No. 159 establishes a fair value option under which entities can elect to report certain financial assets and liabilities at fair value, with changes in fair value recognized in earnings. The Company does not believe the adoption of SFAS No. 159 will have a material impact on its operating results or financial position.

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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders of  
Ross Stores, Inc.  
Pleasanton, California

We have reviewed the accompanying condensed consolidated balance sheets of Ross Stores, Inc. and subsidiaries (the "Company") as of August 4, 2007 and July 29, 2006, and the related condensed consolidated statements of earnings for the three-month and six-month periods ended August 4, 2007 and July 29, 2006, and of cash flows for the six month periods ended August 4, 2007 and July 29, 2006. These condensed consolidated interim financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to such condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Ross Stores, Inc. and subsidiaries as of February 3, 2007, and the related consolidated statements of earnings, stockholders' equity, and cash flows for the year then ended (not presented herein); and in our report (which includes an explanatory paragraph regarding the adoption of a new accounting standard) dated March 29, 2007, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of February 3, 2007, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/Deloitte & Touche LLP

San Francisco, California  
September 11, 2007

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## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This section and other parts of this Form 10-Q contain forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in Part II, Item 1A (Risk Factors) below. The following discussion should be read in conjunction with the condensed consolidated financial statements and notes thereto included elsewhere in this Form 10-Q and the consolidated financial statements and notes thereto in our 2006 Form 10-K. All information is based on our fiscal calendar.

### Overview

We are the second largest off-price apparel and home goods retailer in the United States, with 817 Ross Dress for Less® (Ross) stores in 27 states and Guam, and 45 dd's DISCOUNTS stores in three states at August 4, 2007. Ross offers first-quality, in-season, name brand and designer apparel, accessories, footwear and home fashions at everyday savings of 20% to 60% off department and specialty store regular prices. dd's DISCOUNTS features a more moderately-priced assortment of first-quality, in-season, name brand apparel, accessories, footwear and home fashions at everyday savings of 20% to 70% off moderate department and discount store regular prices.

Our primary strategy is to pursue and refine our existing off-price business, and steadily expand our store base. In establishing growth objectives for our business, we closely monitor market share trends for the off-price industry. Sales for the off-price sector grew by 8% during 2006, which is significantly faster than total national apparel sales, which grew by 5%, according to data from the NPD Group, which provides global sales and marketing information on the retail industry. Our strategies are designed to take advantage of these growth trends and continued customer demand for name-brand fashions for the family and the home at competitive everyday discounts.

### Results of Operations

The following table summarizes the results of operations for the three and six-month periods ended August 4, 2007 and July 29, 2006:

<b>Three Months Ended</b>	<b>Six Months Ended</b>
July 29,	July 29,

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	<b>August 4, 2007</b>	2006	<b>August 4, 2007</b>	2006
<b>Sales</b>				
Sales (millions)	<b>\$ 1,445</b>	\$ 1,308	<b>\$ 2,855</b>	\$ 2,600
Sales growth	<b>10.4%</b>	11.6%	<b>9.8%</b>	13.2%
Comparable store sales growth	<b>2%</b>	4%	<b>1%</b>	5%
<b>Costs and expenses</b> (as a percent of sales)				
Cost of goods sold	<b>78.3%</b>	78.3%	<b>77.1%</b>	77.4%
Selling, general and administrative	<b>15.9%</b>	16.1%	<b>16.1%</b>	16.1%
Interest (income) expense, net	<b>0.0%</b>	(0.1)%	<b>(0.1)%</b>	(0.1)%
<b>Earnings before taxes</b>	<b>5.8%</b>	5.7%	<b>6.8%</b>	6.6%
<b>Net earnings</b>	<b>3.5%</b>	3.5%	<b>4.1%</b>	4.0%

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**Stores.** Our operating strategy is to open additional stores based on local market penetration, local demographic characteristics including population, competition, and the ability to leverage overhead expenses. We continually evaluate opportunistic real estate acquisitions and opportunities for potential new store locations. We also evaluate our current store locations and determine store closures based on similar criteria.

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>August 4, 2007</b>	July 29, 2006	<b>August 4, 2007</b>	July 29, 2006
Stores at the beginning of the period	<b>830</b>	746	<b>797</b>	734
Stores opened in the period	<b>33</b>	25	<b>66</b>	37
Stores closed in the period	<b>(1)</b>	(1)	<b>(1)</b>	(1)
Stores at the end of the period	<b>862</b>	770	<b>862</b>	770

**Sales.** Sales for the three months ended August 4, 2007 increased \$136.6 million, or 10.4%, compared to the three months ended July 29, 2006. This revenue growth was primarily due to the addition of 92 net new stores during the twelve months ended August 4, 2007, and a 2% increase in sales from comparable stores. Sales for the six months ended August 4, 2007 increased \$255.4 million, or 9.8%, compared to the same period in the prior year, primarily due to the impact of the 92 net new stores opened between July 29, 2006 and August 4, 2007, and a 1.0% increase in sales from comparable stores.

Our sales mix for Ross is shown below for the three and six-month periods ended August 4, 2007 and July 29, 2006:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>August 4, 2007</b>	July 29, 2006	<b>August 4, 2007</b>	July 29, 2006
Ladies	<b>34%</b>	35%	<b>35%</b>	35%
Home accents and bed and bath	<b>22%</b>	20%	<b>21%</b>	20%
Men's	<b>15%</b>	16%	<b>15%</b>	15%
Fine jewelry, accessories, lingerie and fragrances	<b>11%</b>	11%	<b>11%</b>	11%

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Children's	8%	8%	8%	9%
Shoes	10%	10%	10%	10%
Total	100%	100%	100%	100%

We expect to address the competitive climate for off-price merchandise by pursuing and refining our existing strategies and by continuing to strengthen our organization, to diversify the merchandise mix, and to more fully develop the organization and systems to strengthen regional and local merchandise offerings. Although our strategies and store expansion program contributed to sales gains for the three and six-month periods ended August 4, 2007, we cannot be sure that they will result in a continuation of sales or profit growth.

**Cost of goods sold.** Cost of goods sold for the three months ended August 4, 2007 increased \$107.2 million compared to the same period in the prior year mainly due to increased sales from the opening of 92 net new stores between July 29, 2006 and August 4, 2007, and a 2.0% increase in sales from comparable stores.

Cost of goods sold as a percentage of sales for the three months ended August 4, 2007 was unchanged from the same period in the prior year. This was the result of a 10 basis point increase in merchandise gross margin, which benefited from a lower inventory shortage provision, a 20 basis point decline in occupancy costs, and a 10 basis point improvement in buying, incentive and equity compensation expenses. These favorable trends were offset by a 20 basis point increase driven by distribution handling costs related to packaway inventory levels and a 20 basis point increase in freight costs.

Cost of goods sold for the six months ended August 4, 2007 increased \$189.6 million compared to the same period in the prior year mainly due to increased sales from the opening of 92 net new stores between July 29, 2006 and August 4, 2007, and a 1.0% increase in sales from comparable stores.

Cost of goods sold as a percentage of sales for the six months ended August 4, 2007 decreased approximately 30 basis points compared with the same period in the prior year. This decrease was the result of a 35 basis point increase in merchandise gross margin, which benefited from a decline in markdowns and a lower inventory shortage provision, and a 20 basis point improvement in buying, incentive and equity compensation expenses. These favorable trends were partially offset by a 20 basis point increase in freight costs and a 5 basis point increase driven by distribution handling costs related to packaway inventory levels.

We cannot be sure that the gross profit margins realized for the three and six-month periods ended August 4, 2007 will continue in the future.

**Selling, general and administrative expenses.** For the three months ended August 4, 2007, selling, general and administrative expenses increased \$18.7 million compared to the same period in the prior year, mainly due to increased store operating costs reflecting the opening of 92 net new stores between July 29, 2006 and August 4, 2007.

Selling, general and administrative expenses as a percentage of sales for the three months ended August 4, 2007 decreased by approximately 20 basis points compared to the same period in the prior year. This improvement was driven by a 50 basis point decline in general and administrative costs, partially offset by a 30 basis point increase in store operating expenses compared to the prior year, primarily due to minimum wage increases.

For the six months ended August 4, 2007, selling, general and administrative expenses increased \$41.7 million compared to the same period in the prior year, mainly due to increased store operating costs reflecting the opening of 92 net new stores between July 29, 2006 and August 4, 2007.

Selling, general and administrative expenses as a percentage of sales for the six months ended August 4, 2007 were unchanged from the same period in the prior year. This was the result of a 40 basis point increase in store operating costs that were offset by a 40 basis point decline in general and administrative costs.

**Taxes on earnings.** Our effective tax rate for the three and six-month periods ended August 4, 2007 and July 29, 2006 was approximately 39%, which represents the applicable combined federal and state statutory rates reduced by the federal benefit of state taxes deductible on federal returns. The effective rate is affected by changes in law, location of new stores, level of earnings and the result of tax audits. We anticipate that our effective tax rate for fiscal 2007 will be approximately 38% to 40%.

**Earnings per share.** Diluted earnings per share increased 16% to \$.37 for the three months ended August 4, 2007, from \$.32 in the prior year period, and increased 16% to \$.85 for the six-month period ended August 4, 2007 from \$.73 in the prior year period. The growth for both the quarter and year-to-date periods was due to a 13% increase in net earnings and a 3% decline in weighted average diluted shares outstanding, which was largely attributable to the repurchase of common stock under the Company's stock repurchase program.

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## Financial Condition

### Liquidity and Capital Resources

Our primary sources of funds for our business activities are existing cash balances, cash flows from operations and short-term trade credit. Our primary ongoing cash requirements are for seasonal and new store merchandise inventory purchases, capital expenditures in connection with opening new stores, and expenditures related to distribution centers, information systems and infrastructure. We also use cash to repay debt, repurchase stock under our stock repurchase program and to pay dividends. Our cash flows for the six months ended August 4, 2007 and July 26, 2006 are as follows:

(\$000)	<b>Six Months Ended</b>	
	<b>August 4, 2007</b>	July 29, 2006
Cash flows provided by operating activities	\$ 7,648	\$ 169,096
Cash flows used in investing activities	(134,585)	(142,908)
Cash flows used in financing activities	(107,643)	(158,604)
Net decrease in cash and cash equivalents	\$ (234,580)	\$ (132,416)

### Operating Activities

Net cash provided by operating activities was \$7.6 million for the six months ended August 4, 2007 compared to \$169.1 million for the six months ended July 29, 2006. The primary sources of cash from operations for the six months ended August 4, 2007 and July 29, 2006 were net earnings plus non-cash expenses for depreciation and amortization, and stock-based compensation. The decrease in cash flows from operations for the six months ended August 4, 2007 was primarily due to a decline in accounts payable from the higher than normal level at February 3, 2007, which was mainly due to the timing of payments and receipts associated with the 53<sup>rd</sup> week in fiscal 2006. Accounts payable leverage (defined as accounts payable divided by merchandise inventory) was 66.4% as of February 3, 2007 and declined to 56.0% as of August 4, 2007.

Working capital (defined as current assets less current liabilities) was \$447.1 million as of August 4, 2007, compared to \$270.5 million as of July 29, 2006. Our primary source of liquidity is the sale of our merchandise inventory. We regularly review the age and condition of our merchandise and are able to maintain current merchandise inventory in our stores through replenishment processes and liquidation of slower-moving merchandise through clearance markdowns.

### Investing Activities

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During the six-month periods ended August 4, 2007 and July 29, 2006, our capital expenditures were approximately \$107.3 million and \$146.1 million, respectively, (excluding leased equipment) for fixtures and leasehold improvements to open new stores, implement information technology systems, implement materials handling equipment and related distribution center systems, and for various other expenditures related to stores and buying and corporate offices. We opened 66 and 37 new stores during the six months ended August 4, 2007 and July 29, 2006, respectively. For the period ended July 29, 2006, our capital expenditures include the purchase of assets under a lease of \$87.3 million. In addition, for the six months ended August 4, 2007 and July 29, 2006, we purchased investments of \$46.9 million and \$47.6 million, respectively, and received proceeds from the sale of investments of \$19.6 million and \$50.8 million, respectively.

We are forecasting approximately \$290 million in total capital expenditures for 2007 to fund store opening improvements for new Ross and dd's DISCOUNTS stores, to fund the relocation or upgrade of existing stores, and to fund investments in store and merchandising systems, distribution center land, buildings, equipment and systems, and various buying and corporate office expenditures. We expect to fund remaining 2007 capital expenditures out of existing cash balances and operating cash flows.

### Financing Activities

During the six-month periods ended August 4, 2007 and July 29, 2006, our liquidity and capital requirements were provided by available cash and investment balances, cash flows from operations and trade credit. Substantially all of our store locations, buying offices, our corporate headquarters, and one distribution center are leased. We own our distribution centers in Carlisle, Pennsylvania, Moreno Valley, California, and Fort Mill, South Carolina.

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In March 2006, we repaid a \$50.0 million term debt in full.

Under our \$400.0 million two-year stock repurchase program announced in 2005, we repurchased 3.1 million and 3.6 million shares of common stock for an aggregate purchase price of approximately \$100.6 million and \$98.9 million during the six-month periods ended August 4, 2007 and July 29, 2006, respectively.

Short-term trade credit represents a significant source of financing for merchandise inventory. Trade credit arises from customary payment terms and trade practices with our vendors. We regularly review the adequacy of credit available to us from all sources and expect to be able to maintain adequate trade, bank and other credit lines to meet our capital and liquidity requirements, including lease obligations in 2007.

The table below presents our significant contractual payment obligations as of August 4, 2007:

(\$000)	Less than 1 Year	1 - 3 Years	3 - 5 Years	After 5 Years	Total <sup>1</sup>
<b>Contractual Obligations</b>					
Senior notes	\$ -	\$ -	\$ -	\$ 150,000	\$ 150,000
Interest payment obligations	9,667	19,335	19,335	74,364	122,701
Operating Leases:					
Rent obligations	285,973	518,170	402,491	459,784	1,666,418
Synthetic leases	9,951	10,014	8,182	4,091	32,238
Other synthetic lease obligations	2,780	3,122	-	56,000	61,902
Purchase obligations	1,091,530	39,171	1,301	-	1,132,002
<b>Total contractual obligations</b>	<b>\$ 1,399,901</b>	<b>\$ 589,812</b>	<b>\$ 431,309</b>	<b>\$ 744,239</b>	<b>\$ 3,165,261</b>

1 Pursuant to the guidelines of FIN 48, a \$28.3 million reserve for unrecognized tax benefits is included in other long-term liabilities on the Company's condensed consolidated balance sheet. These obligations are excluded from the schedule above as the timing of payments cannot be reasonably estimated.

**Senior notes.** In October 2006, we entered into a Note Purchase Agreement with various institutional investors for \$150.0 million of unsecured, senior notes. The notes were issued in two series and funding occurred in December 2006. The Series A notes were issued for an aggregate of \$85.0 million, are due in December 2018, and bear interest at a rate of 6.38%. The Series B notes were issued for an aggregate of \$65.0 million, are due in December 2021, and bear interest at a rate of 6.53%. Interest on these notes is included in interest payment obligations in the table above.

### Off-Balance Sheet Arrangements

**Operating leases.** Substantially all of our store sites, one of our distribution centers, and our buying offices and corporate headquarters are leased.

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We have lease arrangements for certain equipment in our stores for our point-of-sale ("POS") hardware and software systems. These leases are accounted for as operating leases for financial reporting purposes. The initial terms of these leases are two years, and we typically have options to renew the leases for two to three one-year periods. Alternatively, we may purchase or return the equipment at the end of the initial or each renewal term. We have guaranteed the value of the equipment of \$5.9 million, at the end of the respective initial lease terms, which is included in other synthetic lease obligations in the table above.

**Other financings.** We lease a 1.3 million square foot distribution center in Perris, California. The land and building for this distribution center is financed under a \$70.0 million ten-year synthetic lease that expires in July 2013. Rent expense on this center is payable monthly at a fixed annual rate of 5.8% on the lease balance of \$70.0 million. At the end of the lease term, we have the option to either refinance the \$70.0 million synthetic lease facility, purchase the distribution center at the amount of the then-outstanding lease obligation, or arrange a sale of the distribution center to a third party. If the distribution center is sold to a third party for less than \$70.0 million, we have agreed under a residual value guarantee to pay the lessor any shortfall amount up to \$56.0 million. Our contractual obligation of \$56.0 million is included in other synthetic lease obligations in the above table.

In accordance with Financial Accounting Standards Board ("FASB") Interpretation ("FIN") No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," we have recognized a liability and corresponding asset for the fair value of the residual value guarantee in the amount of \$8.3 million for the Perris, California distribution center and \$1.8 million for the POS lease. These residual value guarantees are being amortized on a straight-line basis over the original terms of the leases. The current portion of the related asset and liability is recorded in prepaid expenses and other, and accrued expenses and other, respectively, and the long-term portion of the related assets and liabilities is recorded in other long-term assets and other long-term liabilities, respectively, in the accompanying Condensed Consolidated Balance Sheets.

The synthetic lease facilities described above, as well as our revolving credit facility and senior notes, have covenant restrictions requiring us to maintain certain interest coverage and leverage ratios. In addition, the interest rates under these agreements may vary depending on actual interest coverage ratios achieved. As of August 4, 2007 we were in compliance with these covenants.

In addition, we lease two separate warehouse facilities for packaway storage in Carlisle, Pennsylvania under operating leases expiring through 2011. In June 2006, we entered into a two-year lease extension with one one-year option for a warehouse facility in Fort Mill, South Carolina, extending the term to February 2009. These three leased facilities are being used primarily to store packaway merchandise.

**Purchase obligations.** As of August 4, 2007 we had purchase obligations of \$1.1 billion. These purchase obligations primarily consist of merchandise inventory purchase orders, commitments related to store fixtures and supplies, and information technology service and maintenance contracts. Merchandise inventory purchase orders



of \$997.8 million represent purchase obligations of less than one year as of August 4, 2007.

**Albertsons real estate transaction.** In October 2006, we announced an agreement with Albertsons LLC to acquire certain leasehold rights to 46 former Albertsons sites in California, Florida, Texas, Arizona, Colorado and Oklahoma. We have incorporated about 40 of these sites into our 2007 new store expansion program, of which 27 sites have opened in the first six months of 2007. This real estate opportunity gives us the ability to acquire a substantial number of store sites in several of our established, top performing markets.

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## Commercial Credit Facilities

The table below presents our significant available commercial credit facilities at August 4, 2007:

(\$000)	Amount of Commitment Expiration Per Period				Total amount committed
	Less than 1 year	1 - 3 years	3 - 5 years	After 5 years	
<b>Commercial Credit Commitments</b>					
Revolving credit facility	\$ -	\$ -	\$ 600,000	\$ -	\$ 600,000
<b>Total commercial commitments</b>	\$ -	\$ -	\$ 600,000	\$ -	\$ 600,000

**Revolving credit facility.** We have available a \$600.0 million revolving credit facility with our banks, which contains a \$300.0 million sublimit for issuances of standby letters of credit, of which \$229.9 million was available at August 4, 2007. This facility which expires in July 2011 has a LIBOR-based interest rate plus an applicable margin (currently 45 basis points) and is payable upon maturity but not less than quarterly. Our borrowing ability under this credit facility is subject to our maintaining certain interest coverage and leverage ratios. We have had no borrowings under this facility.

**Standby letters of credit.** We use standby letters of credit to collateralize certain obligations related to our self-insured workers' compensation and general liability claims. We had \$70.1 million and \$63.5 million in standby letters of credit outstanding at August 4, 2007 and July 29, 2006, respectively.

**Trade letters of credit.** We had \$22.1 million and \$28.7 million in trade letters of credit outstanding at August 4, 2007 and July 29, 2006, respectively.

**Dividends.** In August 2007, our Board of Directors declared a cash dividend payment of \$.075 per common share, payable on or about October 1, 2007. In January and May of 2007, our Board of Directors declared a quarterly cash dividend of \$.075 per common share, paid in March and July of 2007, respectively. Our Board of Directors declared quarterly cash dividends of \$.06 per common share in January, May, August, and November 2006.

**Stock repurchase programs.** In November 2005, we announced that our Board of Directors authorized a two-year stock repurchase program of up to \$400.0 million for 2006 and 2007. We repurchased 3.1 million and 3.6 million shares of common stock for aggregate purchase prices of approximately \$100.6 million and \$98.9 million for the six months ended August 4, 2007 and July 29, 2006, respectively.

We estimate that cash flows from operations, bank credit lines and trade credit are adequate to meet operating cash needs, fund our planned capital investments, repurchase common stock and make quarterly dividend payments for at least the next twelve months.

## Critical Accounting Policies

The preparation of our consolidated financial statements requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements. These estimates and assumptions are evaluated on an ongoing basis and are based on historical experience and on various other factors that management believes to be reasonable. We believe the following critical accounting policies describe the more significant judgments and estimates used in the preparation of our condensed consolidated financial statements.

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**Merchandise inventory.** Our merchandise inventory is stated at the lower of cost or market, with cost determined on a weighted average cost method. We purchase manufacturer overruns and canceled orders both during and at the end of a season which are referred to as "packaway" inventory. Packaway inventory is purchased with the intent that it will be stored in our warehouses until a later date, which may even be the beginning of the same selling season in the following year. Included in the carrying value of our merchandise inventory is a provision for shortage. The shortage reserve is based on historical shortage rates as evaluated through our periodic physical merchandise inventory counts and cycle counts. If actual market conditions, markdowns, or shortage are less favorable than those projected by us, or if sales of the merchandise inventory are more difficult than anticipated, additional merchandise inventory write-downs may be required.

**Long-lived assets.** We record a long-lived asset impairment charge when events or changes in circumstances indicate that the carrying amount of a long-lived asset may not be recoverable based on estimated future cash flows. An impairment loss would be recognized if analysis of the undiscounted cash flow of an asset group was less than the carrying value of the asset group. If our actual results differ materially from projected results, an impairment charge may be required in the future. In the course of performing this analysis, we determined that no long-lived asset impairment charge was required for the six months ended August 4, 2007 and July 29, 2006.

**Depreciation and amortization expense.** Property and equipment are stated at cost, less accumulated depreciation and amortization. Depreciation is calculated using the straight-line method over the estimated useful life of the asset, typically ranging from five to twelve years for equipment and 20 to 40 years for buildings and improvements. The cost of leasehold improvements is amortized over the estimated useful life of the asset or the applicable lease term, whichever is less.

**Lease accounting.** When a lease contains rent holidays or requires fixed escalations of the minimum lease payments, we record rental expense on a straight-line basis and the difference between the average rental amount charged to expense and the amount payable under the lease is recorded as deferred rent. We amortize deferred rent on a straight-line basis over the lease term commencing on the possession date. Tenant improvement allowances are included in other long-term liabilities and are amortized over the lease term. Tenant improvement allowances are included as a component of operating cash flows in the consolidated Statement of Cash Flows.

**Self-insurance.** We self insure certain of our workers' compensation and general liability risks as well as certain coverages under our health plans. Our self-insurance liability is determined actuarially, based on claims filed and an estimate of claims incurred but not reported. Should a greater amount of claims occur compared to what is estimated or the costs of medical care and state statutory requirements increase beyond what was anticipated, our recorded reserves may not be sufficient and additional charges could be required.

**Stock-based compensation.** We account for stock-based compensation under the provisions of SFAS No. 123(R). The determination of the fair value of stock options and ESPP shares, using the Black-Scholes model, is affected by our stock price as well as assumptions as to our expected stock price volatility over the term of the awards, actual and projected employee stock option exercise behavior, the risk-free interest rate and expected dividends.

SFAS No. 123(R) requires companies to estimate future expected forfeitures at the date of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. We use historical data to estimate pre-vesting forfeitures and to recognize stock-based compensation expense. All stock-based compensation awards are amortized on a straight-line basis over the requisite service periods of the awards.

The critical accounting policies noted above are not intended to be a comprehensive list of all of our accounting policies. In many cases, the accounting treatment of a particular transaction is specifically dictated by Generally Accepted Accounting Principles, with no need for management's judgment in their application. There are also areas in which management's judgment in selecting one alternative accounting principle over another would not produce

a materially different result.

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### **New Accounting Pronouncements**

SFAS No. 157, "Fair Value Measurements" (SFAS No. 157) is effective for fiscal years beginning after November 15, 2007. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands required disclosures regarding fair value measurements. We do not believe the adoption of SFAS No. 157 will have a material impact on our operating results or financial position.

SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS 159) is effective for fiscal years beginning after November 15, 2007. SFAS No. 159 establishes a fair value option under which entities can elect to report certain financial assets and liabilities at fair value, with changes in fair value recognized in earnings. We do not believe the adoption of SFAS No. 159 will have a material impact on our operating results or financial position.

### **Forward-Looking Statements**

This report may contain a number of forward-looking statements regarding, without limitation, planned store growth, new markets, expected sales, projected earnings levels, capital expenditures and other matters. These forward-looking statements reflect our then current beliefs, projections and estimates with respect to future events and our projected financial performance, growth, operations and competitive position. The words "plan," "expect," "anticipate," "estimate," "believe," "forecast," "projected," "guidance," "looking ahead" and similar expressions are used to identify forward-looking statements.

Future economic and industry trends that could potentially impact revenue, profitability, and growth remain difficult to predict. As a result, our forward-looking statements are subject to risks and uncertainties which could cause our actual results to differ materially from those forward-looking statements and our previous expectations and projections. Refer to Part II, Item 1A in this quarterly report on Form 10-Q for a more complete discussion of risk factors for Ross and dd's DISCOUNTS. The factors underlying our forecasts are dynamic and subject to change. As a result, any forecasts or forward-looking statements speak only as of the date they are given and do not necessarily reflect our outlook at any other point in time. We disclaim any obligation to update or revise these forward-looking statements.

Other risk factors are detailed in our filings with the Securities and Exchange Commission including, without limitation, our annual report on Form 10-K for 2006.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

We are exposed to market risks, which primarily include changes in interest rates. We do not engage in financial transactions for trading or speculative purposes.

We occasionally use forward contracts to hedge against fluctuations in foreign currency exchange rates. We had no outstanding forward contracts at August 4, 2007.

Interest that is payable on our revolving credit facilities is based on variable interest rates and is, therefore, affected by changes in market interest rates. As of August 4, 2007, we had no borrowings outstanding under our revolving credit facilities.

A hypothetical 100 basis point increase in prevailing market interest rates would not have materially impacted our consolidated financial position, results of operations, or cash flows as of and for the three and six-month period ended August 4, 2007. We do not consider the potential losses in future earnings and cash flows from reasonably possible, near term changes in interest rates to be material.

### **Item 4. Controls and Procedures**

#### **Disclosure Controls and Procedures**

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of our "disclosure controls and procedures" (as defined in Exchange Act Rule 13a-15(e)) as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

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It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system will be met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events.

### **Quarterly Evaluation of Changes in Internal Control Over Financial Reporting**

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, also conducted an evaluation of our internal control over financial reporting to determine whether any change occurred during the second fiscal quarter of 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. Based on that evaluation, our management concluded that there was no such change during the quarter.

## **PART II " OTHER INFORMATION**

### **Item 1. Legal Proceedings**

The matters under the caption "Provision for litigation expense and other legal proceedings" in Note A of Notes to Condensed Consolidated Financial Statements are incorporated herein by reference.

### **Item 1A. Risk Factors**

Our quarterly report on Form 10-Q for our second fiscal quarter 2007, and information we provide in our press releases, telephonic reports and other investor communications, including those on our website, may contain a number of forward-looking statements with respect to anticipated future events and our projected financial performance, growth, operations and competitive position that are subject to risk factors that could cause our actual results to differ materially from those forward-looking statements and our prior expectations and projections. Refer to Management's Discussion and Analysis for a more complete identification and discussion of "Forward-Looking Statements."

Our financial condition, results of operations, cash flows and the performance of our common stock may be adversely affected by a number of risk factors. Risks and uncertainties that apply to both Ross and dd's DISCOUNTS include, without limitation, the following:

### **We are subject to the economic and industry risks that affect large retailers operating in the United States.**

Our business is exposed to the risks of a large, multi-store retailer, which must continually and efficiently obtain and distribute a supply of fresh merchandise throughout a large and growing network of stores. These risks include a number of factors, including:

- An increase in the level of competitive pressures in the retail apparel or home-related merchandise industry.
- Potential changes in the level of consumer spending on or preferences for apparel or home-related merchandise, including the potential impact from uncertainty in mortgage credit markets and higher gas prices.
- Potential changes in geopolitical and/or general economic conditions that could affect the availability of product and/or the level of consumer spending.
- Unseasonable weather trends that could affect consumer demand for seasonal apparel and apparel-related products.

- A change in the availability, quantity or quality of attractive brand-name merchandise at desirable discounts that could impact our ability to purchase product and continue to offer customers a wide assortment of merchandise at competitive prices.
- Potential disruptions in supply chain that could impact our ability to deliver product to our stores in a timely and cost-effective manner.
- A change in the availability, quality or cost of new store real estate locations.

- A downturn in the economy or a natural disaster in California or in another region where we have a concentration of stores or a distribution center. Our corporate headquarters, two distribution centers and 27% of our stores are located in California.
- Potential pressure on freight costs from higher-than-expected fuel surcharges.

**We are subject to operating risks as we attempt to execute on our merchandising and growth strategies.**

The continued success of our business depends, in part, upon our ability to increase sales at our existing store locations, and to open new stores and to operate stores on a profitable basis. Our existing strategies and store expansion programs may not result in a continuation of our anticipated revenue growth or profit growth. In executing our off-price retail strategies and working to improve our efficiency, expand our store network, and reduce our costs, we face a number of operational risks, including:

- Our ability to attract and retain personnel with the retail expertise necessary to execute our strategies.
- Our ability to effectively implement and operate our various supply chain, core merchandising and other information systems, including generation of all necessary data and reports for merchants, allocators and other business users in a timely and cost-effective manner.
- Our ability to successfully implement new processes and systems enhancements that are expected to improve our merchandising capabilities with the goal of being able to plan, buy and allocate product at a more local versus regional level.
- Our ability to improve new store sales and profitability, especially in newer regions and markets.
- Our ability to achieve and maintain targeted levels of productivity and efficiency in our distribution centers.
- Our ability to continue to acquire or lease acceptable new store locations.
- Our ability to identify and to successfully enter new geographic markets.
- Lower than planned gross margin, including higher than planned markdowns, inventory shortage or freight costs.
- Greater than planned operating costs including, among other factors, increases in occupancy costs, advertising costs, and wage and benefit costs, including the impact of changes in labor laws or as a result of class action or other lawsuits relating to wage and hour claims and other labor-related matters.
- Our ability to convert certain Albertsons real estate sites to the Ross and dd s DISCOUNTS formats in a timely and cost effective manner and on acceptable terms, and the ability to achieve targeted levels of sales, profits and cash flows from these acquired store locations.

The above risks could significantly affect our operating results and financial condition.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

Information regarding shares of common stock we repurchased during the second quarter of 2007 is as follows:

<b>Total number of shares (or units)</b>	<b>Average price paid per share</b>	<b>Total number of shares (or units) purchased as part of publicly announced plans or</b>	<b>Maximum number (or approximate dollar value) of shares (or units) that may yet be purchased under the plans or programs</b>
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Period	purchased <sup>1</sup>	(or unit)	programs	(\$000)
May (5/6/2007-6/2/2007)	316,620	\$ 33.06	314,656	\$ 139,000
June (6/3/2007-7/7/2007)	706,613	\$ 31.13	704,726	\$ 117,000
July (7/8/2007-8/4/2007)	583,834	\$ 30.09	577,300	\$ 99,000
<b>Total</b>	<b>1,607,067</b>	<b>\$ 31.14</b>	<b>1,596,682</b>	<b>\$ 99,000</b>

<sup>1</sup> We acquired 10,385 shares during the quarter ended August 4, 2007 related to income tax withholdings for restricted stock. All remaining shares were repurchased under the two-year \$400.0 million stock repurchase program publicly announced in November 2005.

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

At our Annual Meeting of Stockholders, held on May 24, 2007 (the "2007 Annual Meeting"), our stockholders voted on and approved the following proposals:

Proposal 1: To elect two Class III directors (Michael J. Bush and Norman A. Ferber) for a three-year term.

Proposal 2: To ratify the appointment of Deloitte & Touche LLP as the Company's independent registered public accounting firm for the fiscal year ending February 2, 2008.

#### 2007 Annual Meeting Election Results

Proposal 1: Election of directors

Director	In favor	Withheld	Term expires
Michael J. Bush	120,596,623	9,587,805	2010
Norman A. Ferber	113,873,022	16,311,406	2010

Proposal 2: Ratification of the appointment of Deloitte & Touche LLP as the Company's independent registered public accounting firm for the fiscal year ending February 2, 2008.

For	Against	Abstain
128,420,488	1,740,620	23,320

#### Item 6. Exhibits

Incorporated herein by reference to the list of Exhibits contained in the Exhibit Index within this Report.

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#### SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

**ROSS STORES, INC.**

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(Registrant)

Date: September 12, 2007

By: /s/ J. Call  
John G. Call  
Senior Vice President, Chief Financial Officer,  
Principal Accounting Officer and Corporate Secretary

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**INDEX TO EXHIBITS**

Exhibit Number	Exhibit
3.1	Amendment of Certificate of Incorporation dated May 21, 2004 and Amendment of Certificate of Incorporation dated June 5, 2002 and Corrected First Restated Certificate of Incorporation, incorporated by reference to Exhibit 3.1 to the Form 10-Q filed by Ross Stores for its quarter ended July 31, 2004.
3.2	Amended By-laws, dated August 25, 1994, incorporated by reference to Exhibit 3.2 to the Form 10-Q filed by Ross Stores for its quarter ended July 30, 1994.
10.1	Sixth Amendment to the Independent Contractor Consultancy Agreement executed June 2007 between Norman A. Ferber and Ross Stores, Inc.
15	Letter re: Unaudited Interim Financial Information from Deloitte & Touche LLP dated September 11, 2007.
31.1	Certification of Chief Executive Officer Pursuant to Sarbanes-Oxley Act Section 302(a).
31.2	Certification of Chief Financial Officer Pursuant to Sarbanes-Oxley Act Section 302(a).
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350.
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350.

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