ROSS STORES INC
Form 10-Q
December 06, 2006

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 October 28, 2006

or

o **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	**94-1390387**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
4440 Rosewood Drive, Pleasanton, California	**94588-3050**
(Address of principal executive offices)	**(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.

YesNo
x o

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

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

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

YesNo
o x

The number of shares of Common Stock, with $.01 par value, outstanding on November 16, 2006 was 139,748,624.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Condensed Consolidated Statements of Earnings

	Three Months Ended		Nine Months Ended	
($000, except per share data, unaudited)	**October 28, 2006**	**October 29, 2005**	**October 28, 2006**	**October 29, 2005**
Sales	**$ 1,362,045**	$ 1,236,892	**$ 3,961,773**	$ 3,532,691
Costs and expenses				
Cost of goods sold	**1,073,820**	979,887	**3,086,786**	2,764,052
Selling, general and administrative	**217,586**	197,740	**635,388**	558,445
Interest income, net	**(1,775)**	(461)	**(5,213)**	(1,339)
Total costs and expenses	**1,289,631**	1,177,166	**3,716,961**	3,321,158
Earnings before taxes	**72,414**	59,726	**244,812**	211,533
Provision for taxes on earnings	**28,481**	23,401	**96,285**	82,879
Net earnings	**$ 43,933**	$ 36,325	**$ 148,527**	$ 128,654
Earnings per share				
Basic	**$ .32**	$ .25	**$ 1.06**	$ .89
Diluted	**$ .31**	$ .25	**$ 1.04**	$ .87
Weighted average shares outstanding (000)				
Basic	**138,570**	143,753	**140,184**	144,954
Diluted	**140,887**	145,659	**142,672**	147,150
Dividends per share				
Cash dividends declared per share	**$ .06**	$ .05	**$ .12**	$ .10
Stores open at end of period	**798**	735	**798**	735

See notes to condensed consolidated financial statements.

Condensed Consolidated Balance Sheets

($000, unaudited)	October 28, 2006	January 28, 2006	October 29, 2005
		(Note A)	
Assets			
Current assets			
Cash and cash equivalents	**$ 122,069**	$ 191,767	$ 177,753
Short-term investments	**4,857**	12,763	
Accounts receivable	**36,823**	29,122	35,246
Merchandise inventory	**1,065,549**	938,091	1,064,972
Prepaid expenses and other	**51,326**	37,090	44,705
Deferred income taxes	**20,014**	20,014	8,968
Total current assets	**1,300,638**	1,228,847	1,331,644
Property and equipment			
Land and buildings	**141,098**	74,298	71,601
Fixtures and equipment	**810,115**	740,540	713,393
Leasehold improvements	**392,699**	376,411	365,652
Construction-in-progress	**41,684**	21,266	26,431
	1,385,596	1,212,515	1,177,077
Less accumulated depreciation and amortization	**645,211**	572,663	547,773
Property and equipment, net	**740,385**	639,852	629,304
Other long-term assets	**60,267**	58,837	53,593
Long-term investments	**30,838**	11,202	
Total assets	**$ 2,132,128**	$ 1,938,738	$ 2,014,541
Liabilities and stockholders equity			
Current liabilities			
Accounts payable	**$ 670,578**	$ 474,614	$ 653,936
Accrued expenses and other	**224,260**	200,723	173,620
Accrued payroll and benefits	**152,688**	128,060	117,858
Income taxes payable		25,586	
Short-term debt		50,000	
Total current liabilities	**1,047,526**	878,983	945,414
Long-term debt			50,000
Other long-term liabilities	**128,503**	122,926	119,955
Deferred income taxes	**97,363**	100,657	96,975
Commitments and contingencies			
Stockholders equity			
Common stock	**1,406**	1,448	1,454
Additional paid-in capital	**520,394**	522,566	507,456
Treasury stock	**(21,180)**	(18,244)	(17,682)
Deferred compensation		(29,375)	(33,424)
Accumulated other comprehensive income	**25**	20	
Retained earnings	**358,091**	359,757	344,393
Total stockholders equity	**858,736**	836,172	802,197
Total liabilities and stockholders equity	**$ 2,132,128**	$ 1,938,738	$ 2,014,541

See notes to condensed consolidated financial statements.

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Condensed Consolidated Statements of Cash Flows

($000, unaudited)	Nine Months Ended October 28, 2006	Nine Months Ended October 29, 2005
Cash Flows from Operating Activities		
Net earnings	**$ 148,527**	$ 128,654
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	**78,680**	69,073
Stock-based compensation	**20,121**	12,384
Deferred income taxes	**(496)**	4,774
Tax benefit from equity issuance	**11,943**	18,102
Excess tax benefits from stock-based compensation	**(4,509)**	
Change in assets and liabilities:		
Merchandise inventory	**(127,458)**	(211,860)
Other current assets, net	**(21,937)**	(2,041)
Accounts payable	**204,604**	209,410
Other current liabilities	**15,145**	31,779
Other long-term, net	**5,629**	3,926
Net cash provided by operating activities	**330,249**	264,201
Cash Flows Used in Investing Activities		
Purchase of assets under lease	**(87,329)**	
Other additions to property and equipment	**(93,365)**	(139,331)
Sales (purchases) of investments, net	**(11,726)**	67,400
Net cash used in investing activities	**(192,420)**	(71,931)
Cash Flows Used in Financing Activities		
Repayment of term debt	**(50,000)**	
Issuance of common stock related to stock plans	**13,991**	31,238
Excess tax benefits from stock-based compensation	**4,509**	
Treasury stock purchased	**(2,935)**	(6,065)
Repurchase of common stock	**(147,726)**	(132,976)
Dividends paid	**(25,366)**	(22,045)
Net cash used in financing activities	**(207,527)**	(129,848)
Net (decrease) increase in cash and cash equivalents	**(69,698)**	62,422
Cash and cash equivalents:		
Beginning of period	**191,767**	115,331
End of period	**$ 122,069**	$ 177,753
Non-Cash Investing Activities		
Straight-line rent capitalization in build-out period	**$**	$ 3,059
Change in fair value of investment securities	**$ 5**	$

See notes to condensed consolidated financial statements.

Notes to Interim Condensed Consolidated Financial Statements

Three and Nine Months Ended October 28, 2006 and October 29, 2005
(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 except as described below) necessary to present fairly the Company s financial position as of October 28, 2006 and October 29, 2005; the results of operations for the three and nine months ended October 28, 2006 and October 29, 2005; and cash flows for the nine months ended October 28, 2006 and October 29, 2005. The Condensed Consolidated Balance Sheet as of January 28, 2006, 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 January 28, 2006. 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 January 28, 2006.

The results of operations for the three and nine-month periods herein presented are not necessarily indicative of the results to be expected for the full year.

Stock-based compensation. Effective in fiscal year 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 123(R), Share-Based Payment, and elected to adopt the standard using the modified prospective transition method. SFAS No. 123(R) replaces SFAS No. 123, Accounting for Stock-Based Compensation, and supersedes Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees. This new accounting standard requires recognition of compensation expense based upon the grant date fair value of all stock-based awards, typically over the vesting period. Prior periods were not revised for comparative purposes.

Reclassifications. In prior periods, stock-based compensation expense and incentive compensation expense were included in selling, general and administrative expenses. In accordance with SEC Staff Accounting Bulletin (SAB) No. 107, which provides guidance on implementation of SFAS No. 123(R), all compensation-related expenses should be recorded in a manner similar to other employee payroll costs. Therefore, for prior periods, the Company has reclassified the portion of stock-based compensation and incentive compensation that relates to personnel in the merchandising and distribution organizations from selling, general and administrative expense to cost of goods sold. Beginning in fiscal year 2006, the portion of stock option and employee stock purchase plan (ESPP) expenses included in stock-based compensation expense for personnel in the merchandising and distribution organizations is included in cost of goods sold.

Under the provisions of SFAS No. 123(R), deferred compensation previously reported as a contra-equity amount and representing the amount of unamortized value of restricted stock issued is no longer reported separately. Accordingly, deferred compensation in the Condensed Consolidated Balance Sheet as of October 28, 2006 is included in additional paid-in capital. In addition, amortization of deferred compensation related to restricted stock is now reported as stock-based compensation in the Condensed Consolidated Statements of Cash Flows, rather than as depreciation and amortization.

See Note B for more information on the Company s stock-based compensation plans and implementation of SFAS No. 123(R).

Lease accounting. Beginning in the first quarter of 2006, the Company adopted the Financial Accounting Standards Board (FASB) Staff Position (FSP) 13-1, Accounting for Rental Costs Incurred During a Construction Period, which requires that rental costs incurred during a construction period be expensed, not capitalized. Implementation of this new standard did not have a significant impact on the Company s financial results for the three and nine-month periods ended October 28, 2006. When a lease contains rent holidays or requires fixed escalations of the minimum lease payments, the Company records rental expense on a straight-line basis over the term of the lease and the difference between the average rental amount charged to expense and the amount payable under the lease is recorded as deferred rent. The Company amortizes 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 Condensed Consolidated Statements of Cash Flows.

Provision for litigation expense and other legal proceedings. The Company is a party in various 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.

Like many California retailers, the Company has been named in class action lawsuits regarding employee payroll and wage claims. The Orange County Superior Court has certified a class in a case involving whether the Company s assistant store managers in California are correctly classified as exempt managers under California Wage Orders. This is a procedural ruling and does not address the merits of the case. In the opinion of management, resolution of this matter 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 value. To date, the Company has granted stock options and restricted stock shares under the 2004 Plan. 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. 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 four years.

Employee Stock Purchase Plan. Under the 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.

Stock-based compensation. The Company adopted the provisions of SFAS No. 123(R) on January 29, 2006, the beginning of its 2006 fiscal year, using the modified prospective method. Under SFAS No. 123(R), compensation expense is recognized based on the grant date fair value of stock-based compensation awards granted in fiscal 2006 and later, and based on the unvested portion of awards from prior year grants that were outstanding as of January 28, 2006. Stock-based awards are valued using the Black-Scholes option pricing model, consistent with the Company s prior pro forma disclosures under SFAS No. 123. Compensation expense for unvested awards outstanding at the date of adoption is recognized over the remaining vesting period using the compensation cost calculated for purposes of the prior pro forma disclosures. For awards granted after the adoption date, the Company recognizes expense based on the fair value of the award on a straight-line basis over the applicable vesting period.

For the three and nine-month periods ended October 28, 2006 and October 29, 2005, the Company recognized stock-based compensation expense as follows (in $000):

	Three Months Ended		Nine Months Ended	
	October 28, 2006	**October 29, 2005**	**October 28, 2006**	**October 29, 2005**
Stock options and ESPP	**$ 3,232**	$	**$ 10,004**	$
Restricted stock	**3,268**	4,511	**10,117**	12,384
Total	**$ 6,500**	$ 4,511	**$ 20,121**	$ 12,384

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 that are used in the valuation models are based upon yields of U.S. Treasury issues with remaining terms similar to the expected term on the options. Dividend yield has been estimated based on the Company s expectation as to future dividend payouts.

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. In previous fiscal years, the Company had recognized the impact of forfeitures as they occurred. Now, 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 Black-Scholes option pricing model and the following weighted average assumptions:

	Three Months Ended		Nine Months Ended	
Stock Options	**October 28, 2006**	**October 29, 2005**	**October 28, 2006**	**October 29, 2005**
Expected life from grant date (years)	**3.9**	4.2	**4.2**	3.4
Expected volatility	**30.3%**	32.9%	**32.5%**	33.8%
Risk-free interest rate	**5.1%**	4.4%	**4.6%**	3.8%
Dividend yield	**0.9%**	0.8%	**0.8%**	0.7%

	Three Months Ended		Nine Months Ended	
Employee Stock Purchase Plan	**October 28, 2006**	**October 29, 2005**	**October 28, 2006**	**October 29, 2005**
Expected life from grant date (years)	**1.0**	1.0	**1.0**	1.0
Expected volatility	**26.7%**	30.9%	**26.7%**	30.9%
Risk-free interest rate	**4.5%**	2.9%	**4.5%**	2.9%
Dividend yield	**0.8%**	0.7%	**0.8%**	0.7%

Total stock-based compensation recognized in the Company s Condensed Consolidated Statements of Earnings for the periods ended October 28, 2006 and October 29, 2005 is as follows (in $000):

	Three Months Ended		Nine Months Ended	
Statements of Earnings Classification	**October 28, 2006**	**October 29, 2005**	**October 28, 2006**	**October 29, 2005**
Cost of goods sold	**$ 2,591**	$ 2,161	**$ 8,464**	$ 5,932
Selling, general and administrative	**3,909**	2,350	**11,657**	6,452
Total	**$ 6,500**	$ 4,511	**$ 20,121**	$ 12,384

Prior to fiscal 2006, the Company had accounted for share-based compensation costs in accordance with APB No. 25, as permitted by SFAS No. 123. Had compensation costs for the Company s equity plans been determined based on the fair value at the grant dates for awards under those plans consistent with the methods of SFAS No. 123, the Company s net earnings and earnings per share for the periods ended October 29, 2005 would have been reduced to the pro forma amounts indicated below:

($000, except per share data)		**Three Months Ended October 29, 2005**	**Nine Months Ended October 29, 2005**
Net earnings	As reported	$ 36,325	$ 128,654
Add: Stock-based employee compensation expense included in reported net earnings, net of tax		2,744	7,532
Deduct: Stock-based employee compensation expense determined under the fair value based method for all awards, net of tax		(5,073)	(15,097)
Net earnings	Pro forma	$ 33,996	$ 121,089
Basic earnings per share	As reported	$ .25	$ .89
	Pro forma	$ .24	$ .84
Diluted earnings per share	As reported	$ .25	$ .87
	Pro forma	$ .23	$ .83

The weighted average fair values per share of stock options granted for the three-month periods ended October 28, 2006 and October 29, 2005, were $7.31 and $7.81, and for the nine-month periods ended October 28, 2006 and October 29, 2005, were $8.52 and $7.82, respectively. The weighted average fair values per share of employee stock purchase awards for the three and nine-month periods ended October 28, 2006 and October 29, 2005, were $7.72 and $7.61, respectively.

Stock option activity. The following table summarizes stock option activity for the nine months ended October 28, 2006:

	Number of shares (in thousands)	Weighted average exercise price
Outstanding at January 28, 2006	8,665	$ 20.51
Granted	794	27.70
Exercised	(930)	15.01
Forfeited	(247)	26.93
Outstanding at October 28, 2006	**8,282**	**$ 21.62**

The following table summarizes information about the weighted average remaining contractual life (in years) and the weighted average exercise prices for stock options both outstanding and exercisable as of October 28, 2006 (number of shares in thousands):

	Options outstanding			Options exercisable	
Exercise price range	Number of shares	Remaining life	Exercise price	Number of shares	Exercise price
$ 6.47 to $ 11.03	1,901	2.76	$ 10.08	1,901	$ 10.08
11.06 to 20.90	1,698	5.74	18.18	1,479	18.02
20.90 to 27.81	2,117	8.24	26.03	838	25.16
27.84 to 28.69	1,895	8.25	28.51	498	28.43
$ 28.71 to $ 32.85	671	7.92	29.66	311	29.78
Totals	8,282	6.44	$ 21.62	5,027	$ 17.97

The aggregate intrinsic value (the difference between the market price and the option s exercise price) of options outstanding and options exercisable as of October 28, 2006 was $66.6 million and $58.8 million, respectively.

Restricted stock activity. During the nine-month period ended October 28, 2006, restricted stock awards totaling 379,000 shares were issued and awards totaling 34,000 shares were forfeited. The unamortized compensation expense at October 28, 2006 was $26.9 million. During the period, shares withheld for tax withholding totaled 107,000 shares, and are considered treasury shares which are available for reissuance. As of October 28, 2006, shares subject to repurchase related to unvested restricted stock totaled 2.0 million shares. A total of 3.5 million shares were available for new restricted stock awards under the 2004 Plan as of October 28, 2006.

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 nine months ended October 28, 2006, there were approximately 4,087,500 and 3,757,800 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 nine months ended October 29, 2005, there were approximately 3,464,400 and 2,767,900 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.

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			Nine Months Ended		
	Basic EPS	Effect of Dilutive Common Stock Equivalents	Diluted EPS	Basic EPS	Effect of Dilutive Common Stock Equivalents	Diluted EPS
October 28, 2006						
Shares	**138,570**	**2,317**	**140,887**	**140,184**	**2,488**	**142,672**
Amount	**$ .32**	**$ (.01)**	**$ .31**	**$ 1.06**	**$ (.02)**	**$ 1.04**
October 29, 2005						
Shares	143,753	1,906	145,659	144,954	2,196	147,150
Amount	$ .25	$ .00	$ .25	$ .89	$ (.02)	$ .87

Note D: Debt and Revolving Credit

In March 2006, the Company repaid its $50.0 million term debt in full. The borrowing was made in 2002 to finance the equipment and information systems for the Perris, California distribution center.

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 will be issued in two series. The series A notes will be for an aggregate of $85.0 million, will be due in December 2018, and will bear interest at a rate of 6.38%. The series B notes will be for an aggregate of $65.0 million, will be due in December 2021, and will bear interest at a rate of 6.53%. Issuance of the notes and funding is expected to occur in December 2006.

Note E: Distribution Center Purchase

In May 2006, the Company exercised its option to purchase its Fort Mill, South Carolina distribution center and paid cash in the amount of $87.3 million to acquire the facility from the lessor. The Company estimated the fair value of the components of the facility and the related equipment using various valuation techniques, including appraisals, market prices, and cost data. Amounts recorded for each component are based on these fair value estimates.

Note F: Recently Issued Accounting Standards

In June 2006, the FASB ratified Emerging Issues Task Force (EITF) Issue 06-2, Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB No. 43, Accounting for Compensated Absences (EITF No. 06-2), effective for fiscal years beginning after December 15, 2006. Under EITF No. 06-2, compensation cost associated with a sabbatical or other similar benefit programs should be accrued over the requisite service period. The Company does not believe the adoption of EITF No. 06-02 will have a material impact on the Company s operating results or financial position.

In July 2006, the FASB issued Interpretation Number 48, Accounting for Uncertainty in Income Taxes (FIN No. 48), effective for fiscal years beginning after December 15, 2006. Under FIN No. 48, companies are required to disclose uncertainties in their income tax positions, including information as to tax benefits included in returns and not recognized for financial statement purposes. The Company has not yet quantified the effects of adopting FIN No. 48.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157), effective for fiscal years beginning after November 15, 2007. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The Company does not believe the adoption of SFAS No. 157 will have a material impact on the Company s operating results or financial position.

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans (SFAS No. 158), effective for fiscal years ending after December 15, 2006. This statement requires recognition of the overfunded or underfunded status of defined benefit pension and other postretirement benefit plans as an asset or liability in the balance sheet. SFAS No. 158 does not change the amount of expense that is recorded related to these plans. The Company has not yet quantified the effects of adopting SFAS No. 158.

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 October 28, 2006 and October 29, 2005, and the related condensed consolidated statements of earnings for the three and nine-month periods ended October 28, 2006 and October 29, 2005, and of cash flows for the nine-month periods ended October 28, 2006 and October 29, 2005. These 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 January 28, 2006, and the related consolidated statements of earnings, stockholders equity, and cash flows for the year then ended (not presented herein); and in our report dated April 4, 2006, 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 January 28, 2006, 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
December 5, 2006

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 2005 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 772 Ross Dress for Less® (Ross) stores in 27 states and Guam, and 26 dd s DISCOUNTS® stores in California at October 28, 2006. 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 11.3% during 2005, which is significantly faster than total national apparel sales, which grew by 3.6%, 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

Reclassifications. In prior periods, stock-based compensation expense related to restricted stock grants and incentive compensation expense were included in selling, general and administrative expenses. In accordance with SEC Staff Accounting Bulletin (SAB) No. 107, which provides guidance on implementation of Statement of Financial Accounting Standards (SFAS) No. 123(R), Share-Based Payment, all compensation-related expenses should be recorded in a manner similar to other employee payroll costs. Therefore, for prior periods, we have reclassified the portion of stock-based compensation and incentive compensation that relates to personnel in the merchandising and distribution organizations from selling, general and administrative expense to cost of goods sold. Beginning in fiscal year 2006, the portion of stock option and employee stock purchase plan (ESPP) expenses included in stock-based compensation expense for personnel in the merchandising and distribution organizations is included in cost of goods sold.

The following table summarizes the results of operations for the three and nine month periods ended October 28, 2006 and October 29, 2005:

	Three Months Ended		Nine Months Ended	
	October 28, 2006	**October 29, 2005**	**October 28, 2006**	**October 29, 2005**
Sales				
Sales (millions)	**$ 1,362**	$ 1,237	**$ 3,962**	$ 3,533
Sales growth	**10.1%**	20.4%	**12.1%**	16.7%
Comparable store sales growth	**4%**	9%	**5%**	6%
Costs and expenses (as a percent of sales)				
Cost of goods sold	**78.8%**	79.2%	**77.9%**	78.2%
Selling, general and administrative	**16.0%**	16.0%	**16.0%**	15.8%
Interest income, net	**(0.1)%**	0.0%	**(0.1)%**	0.0%
Earnings before taxes	**5.3%**	4.8%	**6.2%**	6.0%
Net earnings	**3.2%**	2.9%	**3.7%**	3.6%

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.

	Three Months Ended		Nine Months Ended	
	October 28, 2006	**October 29, 2005**	**October 28, 2006**	**October 29, 2005**
Stores at the beginning of the period	**770**	695	**734**	649
Stores opened in the period	**28**	40	**65**	86
Stores closed in the period			**(1)**	
Stores at the end of the period	**798**	735	**798**	735

Sales. Sales for the three months ended October 28, 2006 increased $125.2 million, or 10.1%, compared to the same period in the prior year, due to the impact of the 63 net new stores opened between October 29, 2005 and October 28, 2006, and a 4% increase in sales from comparable stores (defined as stores that have been open for more than 14 complete months). Sales for the nine months ended October 28, 2006 increased $429.1 million, or 12.1%, compared to the same period in the prior year due to the impact of the 63 net new stores opened between October 29, 2005 and October 28, 2006, and a 5% increase in sales from comparable stores.

Our sales mix is shown below for the three and nine-month periods ended October 28, 2006 and October 29, 2005:

	Three Months Ended		Nine Months Ended	
	October 28, 2006	**October 29, 2005**	**October 28, 2006**	**October 29, 2005**
Ladies	**34%**	35%	**35%**	35%
Home accents and bed and bath	**21%**	20%	**20%**	20%
Men s	**14%**	15%	**15%**	14%
Fine jewelry, accessories, lingerie and fragrances	**11%**	11%	**11%**	11%
Children s	**10%**	10%	**9%**	10%
Shoes	**10%**	9%	**10%**	10%
Total	**100%**	100%	**100%**	100%

We expect to address the competitive climate for off-price apparel and home goods 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 nine-month periods ended October 28, 2006, we cannot be sure that they will result in a continuation of revenue or profit growth.

Stock-based compensation. Effective in fiscal year 2006, we adopted SFAS No. 123(R) and elected to adopt the standard using the modified prospective transition method. This new accounting standard requires recognition of compensation expense based on the grant date fair value of all stock-based awards, typically amortized over the vesting period. The impact on results for the three-month period ended October 28, 2006 was to decrease earnings before taxes by approximately $3.2 million, and net income by approximately $2.0 million. The impact on results for the nine-month period ended October 28, 2006 was to decrease earnings before taxes by approximately $10.0 million, and net income by approximately $6.1 million. Prior periods were not revised for comparative purposes.

See Notes A and B to the Notes to the Condensed Consolidated Financial Statements for more information on our implementation of SFAS No. 123(R) and stock-based compensation plans.

Cost of goods sold. Cost of goods sold for the three months ended October 28, 2006 increased $93.9 million compared to the same period in the prior year mainly due to increased sales from the opening of 63 net new stores between October 29, 2005 and October 28, 2006, a 4% increase in sales from comparable stores, and additional stock compensation expenses recognized pursuant to SFAS No. 123(R).

Cost of goods sold as a percentage of sales for the three months ended October 28, 2006 decreased approximately 40 basis points compared with the same period in the prior year. This decrease was mainly driven by a 170 basis point improvement versus the prior year in shrink and related merchandise accounts payable reconciliation charges. This favorable change was partially offset by a 70 basis point increase in logistics costs, driven by a combination of higher freight and higher distribution expenses, and a 20 basis point decline in merchandise gross margin mainly due to higher markdowns. In addition, buying costs, incentive compensation and expenses related to SFAS No. 123(R) increased about 30 basis points and occupancy costs increased by about 10 basis points.

Cost of goods sold for the nine months ended October 28, 2006 increased $322.7 million compared to the same period in the prior year mainly due to increased sales from the opening of 63 net new stores between October 29, 2005 and October 28, 2006, a 5% increase in sales from comparable stores, and additional stock compensation expenses recognized pursuant to SFAS No. 123(R).

Cost of goods sold as a percentage of sales for the nine months ended October 28, 2006 decreased approximately 35 basis points compared with the same period in the prior year. This decrease was mainly driven by a 35 basis point improvement in merchandise margin primarily due to lower shrink and markdowns, and a 15 basis point improvement in logistics costs, reflecting a decline in distribution expenses that more than offset an increase in freight costs. This was partially offset by a 10 basis point increase in occupancy costs and a 5 basis point increase in buying expenses, incentive compensation costs and expenses related to SFAS No. 123(R).

We cannot be sure that the gross profit margins realized for the three and nine-month periods ended October 28, 2006 will continue in the future.

Selling, general and administrative expenses. For the three months ended October 28, 2006, selling, general and administrative expenses increased $19.8 million compared to the same period in the prior year, mainly due to increased store operating costs reflecting the opening of 63 net new stores between October 29, 2005 and October 28, 2006.

Selling, general and administrative expenses as a percentage of sales for the three months ended October 28, 2006 were flat compared to the same period in the prior year. A 15 basis point increase in expenses related to SFAS No. 123(R) was offset by a similar 15 basis point decline in other general and administrative costs. Store-related expenses were relatively flat compared to the prior year.

For the nine months ended October 28, 2006, selling, general and administrative expenses increased $76.9 million compared to the same period in the prior year, mainly due to increased store operating costs reflecting the opening of 63 net new stores between October 29, 2005 and October 28, 2006.

Selling, general and administrative expenses as a percentage of sales for the nine months ended October 28, 2006 increased approximately 25 basis points compared to the same period in the prior year. This increase was mainly driven by a 25 basis point aggregate increase in incentive compensation costs and expenses related to SFAS No. 123(R). Store-related expenses and other general and administrative costs were relatively flat compared to the prior year.

Taxes on earnings. Our effective tax rate for the three and nine-month periods ended October 28, 2006 and October 29, 2005 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 2006 will be approximately 38% to 40%.

Net earnings. The increase in net earnings as a percentage of sales for the three months ended October 28, 2006, compared to the same period in the prior year, is primarily due to lower cost of goods sold and higher interest income, which is partially offset by a slightly higher tax rate as a percentage of sales. Net earnings as a percentage of sales for the nine months ended October 28, 2006 is higher than the prior year primarily due to lower cost of goods sold and higher interest income, which is partially offset by higher selling, general and administrative expenses as a percentage of sales.

Earnings per share. Diluted earnings per share increased to $.31 for the three months ended October 28, 2006 from $.25 in the prior year period, and to $1.04 for the nine-month period ended October 28, 2006 from $.87 in the prior year period, as a result of an increase in net earnings and a decrease in weighted average diluted shares outstanding, which was largely attributable to the repurchase of common stock under the Company s stock repurchase program.

Financial Condition

Liquidity and Capital Resources

Our primary sources of funds for our business activities are 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 investments in distribution centers, information systems and infrastructure. We also use cash to repay debt, repurchase stock under our stock repurchase program and to pay dividends.

	Nine Months Ended	
($000)	**October 28, 2006**	**October 29, 2005**
Cash flows from operating activities	**$ 330,249**	$ 264,201
Cash flows used in investing activities	**(192,420)**	(71,931)
Cash flows used in financing activities	**(207,527)**	(129,848)
Net (decrease) increase in cash and cash equivalents	**$ (69,698)**	$ 62,422

Operating Activities

Net cash provided by operating activities was $330.2 million and $264.2 million for the nine months ended October 28, 2006 and October 29, 2005, respectively. The primary source of cash from operations for the nine months ended October 28, 2006 and October 29, 2005 was net earnings plus non-cash expenses for depreciation and amortization and increased trade credit, partially offset by cash used to finance merchandise inventory. The increase in cash flows from operations for the nine months ended October 28, 2006 is primarily due to a net increase in trade credit financed merchandise inventory. Working capital (defined as current assets less current liabilities) was $253.1 million as of October 28, 2006, compared to $386.2 million as of October 29, 2005. 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

During the nine-month periods ended October 28, 2006 and October 29, 2005, we spent approximately $180.7 million and $139.3 million, respectively, for capital expenditures (excluding leased equipment) for fixtures and leasehold improvements to open new stores, implement information technology systems, install and implement materials handling equipment and related distribution center systems, and various other expenditures related to stores, buying and corporate offices. For the nine-month period ended October 28, 2006, this amount included the purchase of distribution center assets under a lease of $87.3 million. We opened 65 and 86 new stores during the nine months ended October 28, 2006 and October 29, 2005, respectively. In addition, for the nine months ended October 28, 2006 and October 29, 2005, we made net purchases of $11.7 million and received net proceeds from sales of investments of $67.4 million, respectively.

We are forecasting approximately $235.0 million in capital expenditures for 2006 to fund fixtures and leasehold improvements to open both 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. The forecast for full year 2006 capital expenditures was reduced by $30.0 million from previous estimates due to timing changes for certain distribution center related projects. This $235.0 million forecast includes $87.3 million related to our purchase in May 2006 of the leased real estate and other assets at our Fort Mill, South Carolina distribution center. We expect to fund remaining 2006 capital expenditures out of cash flows from operations.

Financing Activities

During the nine-month periods ended October 28, 2006 and October 29, 2005, our liquidity and capital requirements were provided by cash flows from operations and trade credit. Substantially all of our store locations, buying offices, our corporate headquarters, and one distribution center are leased and, except for certain leasehold improvements and equipment, do not represent long-term capital investments. We own our distribution centers in Carlisle, Pennsylvania, Moreno Valley, California, and Fort Mill, South Carolina.

In March 2006, we repaid our $50.0 million term debt outstanding as of January 28, 2006 in full. In May 2006, we exercised our option to purchase our Fort Mill, South Carolina distribution center for $87.3 million.

We repurchased 5.4 million and 4.9 million shares of common stock for an aggregate purchase price of approximately $147.7 million and $133.0 million during the nine-month periods ended October 28, 2006 and October 29, 2005, respectively. These repurchases were funded by cash flows from operations.

Short-term trade credit represents a significant source of financing for investments in 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 2006.

In October 2006, we entered into a Note Purchase Agreement with various institutional investors for $150.0 million of unsecured, senior notes. The notes will be issued in two series. The series A notes will be for an aggregate of $85.0 million, will be due in December 2018, and will bear interest at a rate of 6.38%. The series B notes will be for an aggregate of $65.0 million, will be due in December 2021, and will bear interest at a rate of 6.53%. Issuance of the notes and funding is expected to occur in December 2006.

The table below presents our significant contractual payment obligations as of October 28, 2006:

($000) **Contractual Obligations**	**Less than 1 year**	**1 3 years**	**3 5 years**	**After 5 years**	**Total**
Operating leases	$ 277,181	$ 500,568	$ 392,663	$ 476,533	$ 1,646,945
Other financings:					
Synthetic leases	9,717	9,183	8,181	7,159	34,240
Other synthetic lease obligations	3,001	6,946		56,000	65,947
Purchase obligations	1,486,633	12,473	1,208		1,500,314
Total contractual obligations	$ 1,776,532	$ 529,170	$ 402,052	$ 539,692	$ 3,247,446

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 and, except for certain leasehold improvements and equipment, do not represent long-term capital investments.

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 $9.9 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 being 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 the shortfall below $70.0 million not to exceed $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.

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 our 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.

The synthetic lease facilities described above, as well as our revolving credit facility, 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 October 28, 2006, we were in compliance with these covenants.

Distribution center purchase. In May 2006, we exercised our option to purchase our Fort Mill, South Carolina distribution center and paid cash in the amount of $87.3 million to acquire the facility from the lessor. We estimated the fair value of the components of the facility and the related equipment using various valuation techniques, including appraisals, market prices, and cost data. Amounts recorded for each component are based on these fair value estimates.

Purchase obligations. As of October 28, 2006 we had purchase obligations of $1.5 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 $1.4 billion represent purchase obligations of less than one year as of October 28, 2006.

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 plan to incorporate these properties into our 2007 expansion program. This real estate opportunity gives us the ability to acquire a substantial number of store sites in several of our established, top performing markets. We expect to realize contributions to earnings and cash flow from these additional locations beginning in fiscal year 2007. We expect the leases will be finalized over the next few months.

Commercial Credit Facilities

The table below presents our significant available commercial credit facilities at October 28, 2006:

($000) Commercial Credit Commitments	Amount of Commitment Expiration Per Period: Less than 1 year	1 - 3 years	3 - 5 years	After 5 years	Total amount committed
Revolving credit facility	$	$	$ 600,000	$	$ 600,000
Total commercial commitments	$	$	$ 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 $236.1 million was available at October 28, 2006. In July 2006, we amended this facility to change the expiration date and interest pricing. Interest is LIBOR-based plus an applicable margin (currently 45 basis points) and is payable upon borrowing maturity but no 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, which expires in July 2011.

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 $63.9 million and $61.7 million in standby letters of credit outstanding at October 28, 2006 and October 29, 2005, respectively.

Trade letters of credit. We had $16.8 million and $17.9 million in trade letters of credit outstanding at October 28, 2006 and October 29, 2005, respectively.

Dividends. In November 2006, our Board of Directors declared a cash dividend payment of $.06 per common share, payable on or about January 2, 2007. Our Board of Directors declared quarterly cash dividends of $.06 per common share in August 2006, May 2006, January 2006 and November 2005, and $.05 per common share in January, May and August 2005.

Stock repurchase programs. In November 2005, we announced that our Board of Directors authorized a new two-year stock repurchase program of up to $400.0 million for 2006 and 2007. We repurchased 5.4 million and 4.9 million shares of common stock for aggregate purchase prices of approximately $147.7 million and $133.0 million for the nine months ended October 28, 2006 and October 29, 2005, respectively.

We estimate that cash flows from operations, our planned issuance of senior unsecured notes, 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 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.

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 three and nine months ended October 28, 2006 and October 29, 2005.

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 real property. The cost of leasehold improvements is amortized over the useful life of the asset or the applicable lease term, whichever is less.

Lease accounting. In the first quarter of 2006, we adopted FASB Staff Position (FSP) 13-1, Accounting for Rental Costs Incurred During a Construction Period, which requires that rental costs incurred during a construction period be expensed, not capitalized. 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. Changes in tenant improvement allowances are included as a component of operating activities in the Condensed Consolidated Statements 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 now account for stock-based compensation under the provisions of SFAS No. 123(R). Under SFAS No. 123(R) compensation expense is recognized for the grant date fair value of new awards granted in fiscal 2006 and later, and for the unvested portion of prior year awards that were outstanding as of January 28, 2006. Stock-based awards are valued using the Black-Scholes option pricing model, consistent with our prior pro forma disclosures under SFAS No. 123. Compensation expense for awards outstanding at the effective date is recognized over the remaining vesting period using the compensation cost calculated for purposes of the prior pro forma disclosures. For awards granted after the adoption date, we recognize expense for the fair value of the award on a straight-line basis over the applicable vesting term.

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. In previous fiscal years, we had recognized the impact of forfeitures as they occurred. Now 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.

These 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 (GAAP), 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.

New Accounting Pronouncements

In June 2006, the FASB ratified Emerging Issues Task Force (EITF) Issue 06-2, Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB No. 43, Accounting for Compensated Absences (EITF No. 06-2), effective for fiscal years beginning after December 15, 2006. Under EITF No. 06-2 compensation cost associated with a sabbatical or other similar benefit programs should be accrued over the requisite service period. We do not believe the adoption of EITF No. 06-02 will have a material impact on our operating results or financial position.

In July 2006, the FASB issued Interpretation Number 48, Accounting for Uncertainty in Income Taxes (FIN No. 48), effective for fiscal years beginning after December 15, 2006. Under FIN No. 48, companies are required to disclose uncertainties in their income tax positions, including information as to tax benefits included in returns and not recognized for financial statement purposes. We have not yet quantified the effects of adopting FIN No. 48.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157), effective for fiscal years beginning after November 15, 2007. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about 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.

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans (SFAS No. 158), effective for fiscal years ending after December 15, 2006. This statement requires recognition of the overfunded or underfunded status of defined benefit pension and other postretirement benefit plans as an asset or liability in the balance sheet. SFAS No. 158 does not change the amount of expense that is recorded related to these plans. We have not yet quantified the effects of adopting SFAS No. 158.

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 identi 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 2005.

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. We had no outstanding forward contracts at October 28, 2006.

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 October 28, 2006, 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 nine-month periods ended October 28, 2006. 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.

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 third fiscal quarter of 2006 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 third fiscal quarter.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

The two paragraphs 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 third fiscal quarter 2006, 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 higher gas prices on consumer spending.
- 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 28% of our stores are located in California.
- Potential pressure on freight costs from higher-than-expected fuel surcharges.

These risks could significantly affect the Company s operating results and financial condition.

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 in 2006 and 2007 to successfully implement new processes and systems enhancements that are expected to improve our micro-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.

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

Information regarding shares of common stock we repurchased during the third quarter of 2006 is as follows:

Period	Total number of shares purchased[1]	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum approximate dollar value of shares that may yet be purchased under the plans or programs ($000)
August (7/30/2006-8/26/2006)	476,348	$ 23.49	475,615	$ 290,000
September (8/27/2006-9/30/2006)	849,341	$ 25.42	833,700	$ 269,000
October (10/1/2006-10/28/2006)	556,100	$ 29.97	550,018	$ 252,000
Total	1,881,789	$ 26.27	1,859,333	

[1] We acquired 22,456 shares during the quarter ended October 28, 2006 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 6. Exhibits

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

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.
	(Registrant)
Date: December 6, 2006	By: /s/ J. Call
	John G. Call Senior Vice President, Chief Financial Officer, Principal Accounting Officer and Corporate Secretary

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	First Amendment to the Employment Agreement between Barry Gluck and Ross Stores, Inc. effective October 2, 2006.
10.2	Note Purchase Agreement dated October 17, 2006.
15	Letter re: Unaudited Interim Financial Information from Deloitte & Touche LLP dated December 5, 2006.
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.