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

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**FORM 8-K**

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

**Date of report (Date of earliest event reported): June 15, 2009**

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**Limited Brands, Inc.**

(Exact Name of Registrant as Specified in Its Charter)

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**Delaware**  
(State or Other Jurisdiction  
of Incorporation)

**1-8344**  
(Commission File Number)

**31-1029810**  
(IRS Employer  
Identification No.)

**Three Limited Parkway**  
**Columbus, OH**  
(Address of Principal Executive Offices)

**43230**  
(Zip Code)

**(614) 415-7000**  
(Registrant's Telephone Number, Including Area Code)

**Not Applicable**  
(Former Name or Former Address, if Changed Since Last Report)

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Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instruction A.2. below):

- Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
  - Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
  - Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
  - Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))
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## **Item 8.01 Other Events**

Limited Brands, Inc. (the “Company”) is filing this Current Report on Form 8-K to reflect certain accounting changes described below with respect to the financial information contained in the Company’s Annual Report on Form 10-K for the year ended January 31, 2009 (the “2008 Form 10-K”), which was filed with the United States Securities and Exchange Commission (“SEC”) on March 27, 2009. The information in this Form 8-K is not an amendment to or restatement of the 2008 Form 10-K.

Effective January 1, 2009, the Company adopted SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements* (“SFAS 160”). SFAS 160 requires noncontrolling interests to be reported in equity and establishes a new framework for recognizing net income or loss and comprehensive income by the controlling interest. Upon adoption, prior period financial statements were recast for the presentation of the noncontrolling interest consistent with the retrospective application required by SFAS 160. The adoption of SFAS 160 will permit the Company to incorporate these financial statements in future Securities and Exchange Commission filings. The retrospective application of SFAS 160 impacts only the following items of the 2008 Form 10-K and Exhibit 12 to the 2008 Form 10-K, which are included as Exhibit 99.1 to this Current Report:

- Part II, Item 6—Selected Financial Data
- Part II, Item 7—Management’s Discussion and Analysis of Financial Condition and Results of Operations
- Part II, Item 8—Financial Statements and Supplementary Data
- Exhibit 12—Ratio of Earnings to Fixed Charges

All other information in the 2008 Form 10-K remains unchanged. This Current Report does not modify or update the disclosures therein in any way, nor does it reflect any subsequent information or events, other than as required to reflect adoption of SFAS 160 as described above. Without limitation of the foregoing, this filing does not purport to update Management’s Discussion and Analysis of Financial Condition and Results of Operations included in the 2008 Form 10-K for any information, uncertainties, transactions, risks, events or trends occurring, or known to management. More current information is included in the Company’s Quarterly Report on Form 10-Q for the quarterly period ended May 2, 2009 (the “first quarter 2009 Form 10-Q”). The information in this Current Report should be read in conjunction with the 2008 Form 10-K and the first quarter 2009 Form 10-Q.

## **Item 9.01 Financial Statements and Exhibits**

### **(d) EXHIBITS**

23.1 Consent of Ernst & Young LLP, an Independent Registered Public Accounting Firm

99.1 Part II, Item 6 – Selected Financial Data; Part II, Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations; Part II, Item 8 – Financial Statements and Supplementary Data; Exhibit 12 to the 2008 Form 10-K – Ratio of Earnings to Fixed Charges

**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 hereunto duly authorized.

Limited Brands, Inc.

Date: June 15, 2009

By /s/ STUART B. BURGDOERFER  
Stuart B. Burgdoerfer  
Executive Vice President and  
Chief Financial Officer\*

\* Mr. Burgdoerfer is the principal financial officer and the principal accounting officer and has been duly authorized to sign on behalf of the Registrant.

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in the following Registration Statements of Limited Brands, Inc. and, with respect to the Registration Statement on Form S-3, in the related Prospectus:

Registration Statement (Form S-3ASR No. 333-146420)  
Registration Statement (Form S-8 No. 33-49871)  
Registration Statement (Form S-8 No. 333-110465)  
Registration Statement (Form S-8 No. 333-04927)  
Registration Statement (Form S-8 No. 333-04941)  
Registration Statement (Form S-8 No. 333-118407);

of our report dated March 27, 2009, except for the effects of the adoption of SFAS 160 and related disclosures in Notes 1, 2, and 10 as to which the date is June 12, 2009, with respect to the consolidated financial statements of Limited Brands, Inc. and subsidiaries included in the Current Report (Form 8-K) dated June 15, 2009.

/s/ Ernst & Young LLP

Columbus, Ohio  
June 12, 2009

## ITEM 6. SELECTED FINANCIAL DATA.

|  | Fiscal Year Ended   |                     |  |                         |                     |
|--|---------------------|---------------------|--|-------------------------|---------------------|
|  | January 31,<br>2009 | February 2,<br>2008 | February 3,<br>2007 (a) (b)<br>(in millions) | January 28,<br>2006 (c) | January 29,<br>2005 |
| <b>Summary of Operations</b>   |                     |                     |  |                         |                     |
| Net Sales  | \$ 9,043            | \$ 10,134           | \$ 10,671                                    | \$ 9,699                | \$ 9,408            |
| Gross Profit (d)   | 3,006               | 3,509               | 4,013  | 3,480                   | 3,394               |
| Operating Income (e)   | 589                 | 1,110               | 1,176  | 986                     | 1,027               |
| Income Before Cumulative Effect of Changes in Accounting Principle (f) (j) | 216                 | 696                 | 674  | 666                     | 705                 |
| Cumulative Effect of Changes in Accounting Principle(b)(c)                 | —                   | —                   | 1  | 17                      | —                   |
| Net Income Attributable to Limited Brands, Inc. (f) (j)                    | 220                 | 718                 | 676  | 683                     | 705                 |
| (as a percentage of net sales)   |                     |                     |  |                         |                     |
| Gross Profit (d)   | 33.2%               | 34.6%               | 37.6%  | 35.9%                   | 36.1%               |
| Operating Income   | 6.5%                | 11.0%               | 11.0%  | 10.2%                   | 10.9%               |
| Income Before Cumulative Effect of Changes in Accounting Principle (j)     | 2.4%                | 6.9%                | 6.3%   | 6.9%                    | 7.5%                |
| <b>Per Share Results (j)</b>   |                     |                     |  |                         |                     |
| <i>Net Income Attributable to Limited Brands, Inc. per Basic Share:</i>    |                     |                     |  |                         |                     |
| Income Before Cumulative Effect of Changes in Accounting Principle         | \$ 0.66             | \$ 1.91             | \$ 1.71                                      | \$ 1.66                 | \$ 1.50             |
| Net Income Attributable to Limited Brands, Inc. per Basic Share            | 0.66                | 1.91                | 1.71   | 1.70                    | 1.50                |
| <i>Net Income Attributable to Limited Brands, Inc. per Diluted Share:</i>  |                     |                     |  |                         |                     |
| Income Before Cumulative Effect of Changes in Accounting Principle         | \$ 0.65             | \$ 1.89             | \$ 1.68                                      | \$ 1.62                 | \$ 1.47             |
| Net Income Attributable to Limited Brands, Inc. per Diluted Share          | 0.65                | 1.89                | 1.68   | 1.66                    | 1.47                |
| Dividends per Share (g)  | \$ 0.60             | \$ 0.60             | \$ 0.60                                      | \$ 0.60                 | \$ 1.71             |
| Weighted Average Diluted Shares Outstanding (in millions)                  | 337                 | 380                 | 403  | 411                     | 479                 |
| (in millions)  |                     |                     |  |                         |                     |
| <b>Other Financial Information</b>   |                     |                     |  |                         |                     |
| Cash and Cash Equivalents  | \$ 1,173            | \$ 1,018            | \$ 500                                       | \$ 1,208                | \$ 1,161            |
| Total Assets   | 6,972               | 7,437               | 7,093  | 6,346                   | 6,089               |
| Working Capital  | 1,612               | 1,545               | 1,062  | 1,209                   | 1,233               |
| Net Cash Provided by Operating Activities                                  | 954                 | 765                 | 600  | 1,081                   | 933                 |
| Capital Expenditures   | 479                 | 749                 | 548  | 480                     | 431                 |
| Long-term Debt   | 2,897               | 2,905               | 1,665  | 1,669                   | 1,646               |
| Other Long-term Liabilities  | 732                 | 709                 | 520  | 452                     | 447                 |
| Total Limited Brands, Inc. Shareholders' Equity (j)                        | 1,874               | 2,219               | 2,955  | 2,471                   | 2,335               |
| Return on Average Shareholders' Equity                                     | 11%                 | 28%                 | 25%  | 28%                     | 19%                 |
| Comparable Store Sales (Decrease) Increase (h)                             | (9)%                | (2)%                | 7%   | (1)%                    | 4%                  |
| Return on Average Assets   | 3%                  | 10%                 | 10%  | 11%                     | 10%                 |
| Debt-to-equity Ratio   | 155%                | 131%                | 56%  | 68%                     | 70%                 |
| Current Ratio  | 2.3                 | 2.1                 | 1.6  | 1.8                     | 1.9                 |
| <b>Stores and Associates at End of Year</b>                                |                     |                     |  |                         |                     |
| Number of Stores (i)   | 3,014               | 2,926               | 3,766  | 3,590                   | 3,779               |
| Selling Square Feet (in thousands) (i)                                     | 10,898              | 10,310              | 15,719                                       | 15,332                  | 15,801              |
| Number of Associates   | 90,900              | 97,500              | 125,500                                      | 110,000                 | 115,300             |

- (a) Fifty-three week fiscal year.
- (b) On January 29, 2006, we adopted Statement of Financial Accounting Standards 123 (revised 2004), *Share-Based Payment* (“SFAS 123(R)”), which requires the measurement and recognition of compensation expense for all share-based awards made to employees and directors based on estimated fair values on the grant date. For additional information, see Notes 2 and 20 to the Consolidated Financial Statements included in Item 8. Financial Statements and Supplementary Data.
- The cumulative effect of adopting SFAS 123(R) was \$0.7 million, net of tax of \$0.4 million, and was recognized as an increase to net income in the Consolidated Statement of Income as of the beginning of the first quarter of 2006.
- (c) During the fourth quarter of 2005, we changed our inventory valuation method. Previously, inventories were principally valued at the lower of cost or market, on a weighted-average cost basis, using the retail method. Commencing in 2005, inventories are principally valued at the lower of cost or market, on a weighted-average cost basis, using the cost method.
- The cumulative effect of this change was \$17 million, net of tax of \$11 million. This change was recognized as an increase to net income in the Consolidated Statement of Income as of the beginning of the first quarter of 2005. In addition to the \$17 million cumulative impact recognized as of the beginning of the first quarter, the effect of the change during 2005 was to decrease net income by \$4 million, or \$0.01 per diluted share.
- (d) Amounts presented are restated for 2007 to conform to current period presentation.
- (e) Operating income includes the effect of the following items:
- (i) In 2008, a \$215 million impairment charge related to goodwill and other intangible assets for our La Senza business, a \$128 million gain related to the divestiture of a personal care joint venture, \$23 million of expense related to restructuring activities and a \$19 million impairment charge related to a joint venture.
  - (ii) In 2007, a \$302 million gain related to the divestiture of Express, a \$72 million loss related to the divestiture of Limited Stores, \$48 million related to initial recognition of income for unredeemed gift cards at Victoria’s Secret, \$53 million of expense related to various restructuring activities and \$37 million of gains related to asset sales.
  - (iii) In 2006, \$26 million in incremental share-based compensation expense related to the adoption of SFAS 123(R).
  - (iv) In 2005, \$30 million related to initial recognition of income for unredeemed gift cards at Bath & Body Works and Express.
  - (v) In 2004, a \$61 million charge to correct our accounting for straight-line rent and the depreciation and amortization of leasehold improvements and certain landlord allowances.
- For additional information on 2008, 2007 and 2006 items, see the Notes to the Consolidated Financial Statements included in Item 8. Financial Statements and Supplementary Data.
- (f) In addition to the items previously discussed in (e), net income includes the effect of the following items:
- (i) In 2008, \$15 million of favorable tax benefits in the fourth quarter primarily related to certain discrete foreign and state income tax items and a \$13 million pre-tax gain related to a cash distribution from Express.
  - (ii) In 2007, a \$100 million pre-tax gain related to a cash distribution from Easton Town Center, LLC, a \$17 million pre-tax gain related to an interest rate hedge and \$67 million of favorable tax benefits primarily relating to: 1) the reversal of state net operating loss carryforward valuation allowances and other favorable tax benefits associated with the Apparel divestitures; 2) a decline in the Canadian federal tax rate; 3) audit settlements and 4) other items.
  - (iii) In 2005, a \$77 million favorable one-time tax benefit related to the repatriation of foreign earnings under the provisions of the American Jobs Creation Act and \$40 million of pre-tax interest income related to an Internal Revenue Service tax settlement.
  - (iv) In 2004, pre-tax non-operating gains of \$90 million related to New York & Company and \$18 million related to Galyan’s Trading Company, Inc.
- For additional information on 2008 and 2007 items, see the Notes to the Consolidated Financial Statements included in Item 8. Financial Statements and Supplementary Data.
- (g) In 2004, dividends per share include a special dividend of \$1.23 per share.
- (h) A store is typically included in the calculation of comparable store sales when it has been open or owned 12 months or more and it has not had a change in selling square footage of 20% or more. Additionally, stores of a given brand are excluded if total selling square footage for the brand in the mall changes by 20% or more through the opening or closing of a second store.
- (i) Number of stores and selling square feet excludes independently owned La Senza stores operated by licensees.
- (j) As further discussed in Note 2 of the Notes to Consolidated Financial Statements, amounts have been recast to reflect the retrospective application of SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements*.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION.

The following discussion and analysis of financial condition and results of operations are based upon our Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The following information should be read in conjunction with our financial statements and the related notes included in Item 8. Financial Statements and Supplementary Data.

Our operating results are generally impacted by changes in the U.S. and Canadian economies and, therefore, we monitor the retail environment using, among other things, certain key industry performance indicators such as the University of Michigan Consumer Sentiment Index (which measures consumers' views on the future course of the U.S. economy), the National Retail Traffic Index (which measures traffic levels in malls nationwide) and National Retail Sales (which reflects sales volumes of 5,000 businesses as measured by the U.S. Census Bureau). These indices provide insight into consumer spending patterns and shopping behavior in the current retail environment and assist us in assessing our performance as well as the potential impact of industry trends on our future operating results. Additionally, we evaluate a number of key performance indicators including comparable store sales, gross profit, operating income and other performance metrics such as sales per average selling square foot and inventory per selling square foot in assessing our performance.

### Executive Overview

#### Strategy

Our strategy supports and drives our mission to build a family of the world's best fashion retail brands whose well-told stories create loyal customers and deliver sustained growth for our stakeholders.

To execute our strategy, we are focused on these key strategic imperatives:

- Grow our core brands in current channels and geographies;
- Extend our core brands into larger footprints and new channels and geographies;
- Incubate and grow new brands in current channels;
- Build enabling infrastructure and capabilities;
- Become the top destination for talent; and
- Optimize our capital structure.

### 2008 Overview

We anticipated that the retail environment would be challenging in 2008. However, the holiday season was much more difficult than expected as a result of the global economic downturn and its impact on the U.S. and Canadian retail environment. Our financial performance in 2008 was significantly impacted by the downturn. Our net sales decreased 11% to \$9.043 billion, driven by a comparable store sales decrease of 9%, and our operating income decreased \$521 million to \$589 million. The decline in our operating income included a \$215 million impairment of goodwill and other intangible assets related to our La Senza business. For additional information related to our 2008 financial performance, see "Results of Operations – 2008 Compared to 2007."

As a result of these challenges, we focused on the conservative management of retail fundamentals including:

- Inventory levels – we ended 2008 down 6% and 33% as compared to 2007 and 2006, respectively, and our inventory per selling square foot ended 2008 down 8% and 34% compared to 2007 and 2006, respectively;
- Operating expenses – we have taken actions to reduce our expense base including reducing our home office headcount by approximately 10% during the second quarter of 2007 and an additional 10% during the fourth quarter of 2008;
- Capital expenditures – we reduced our capital expenditures from \$749 million in 2007 to \$479 million in 2008. We are currently planning capital expenditures of approximately \$200 million in 2009;
- Cash and liquidity – we generated cash flow from operations of \$954 million in 2008 and ended 2008 with \$1.2 billion in cash. Additionally, in February 2009, we renegotiated the covenants on our \$750 million term loan and \$1 billion revolving credit facility to provide us additional flexibility in this uncertain environment.

Despite the challenging environment during 2008, we accomplished the following in terms of the execution of our business strategy:

- The stabilization of operations in our new distribution center for Victoria's Secret Direct;
- The divestiture of a personal care joint venture in the first quarter of 2008 which generated pre-tax cash proceeds of \$159 million and a pre-tax gain of \$128 million;
- The successful introduction of Bath & Body Works stores into Canada; and
- The implementation of our new supply chain systems at Mast.

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## **2009 Outlook**

### ***Economic Environment***

The global retail sector and our business continue to face a very uncertain and difficult environment and, as a result, we have taken a defensive stance in terms of the financial management of our business. We will continue to manage our business conservatively and we will focus on the execution of the retail fundamentals noted above.

At the same time, we are aggressively focusing on bringing compelling merchandise assortments, marketing and store experiences to our customers. We will look for, and capitalize on, those opportunities available to us in this difficult environment. We believe that our brands, which lead their categories and offer high emotional content at accessible prices, are well positioned heading into 2009.

### ***International Expansion***

We anticipate opening approximately 20 new Bath & Body Works Canada stores in 2009. The six stores that we opened in 2008 have exceeded our performance expectations. Additionally, we will continue to explore other international opportunities in 2009.

### ***Capital Expenditures***

We plan to spend approximately \$200 million in 2009 on capital expenditures with the majority relating to opening new stores and remodeling and improving existing stores. We expect to open approximately 50 new stores in the U.S. and Canada and to remodel approximately 40 stores during 2009.



## Store Data

The following table compares 2008 store data to the comparable periods for 2007 and 2006:

|  | <u>% Change</u> |             |             |             |             |
|--|-----------------|-------------|-------------|-------------|-------------|
|  | <u>2008</u>     | <u>2007</u> | <u>2006</u> | <u>2008</u> | <u>2007</u> |
| <b><u>Sales Per Average Selling Square Foot</u></b>    |                 |             |             |             |             |
| Victoria's Secret Stores                               | \$ 620          | \$ 694      | \$ 731      | (11)%       | (5)%        |
| La Senza (a) (b) (c)                                   | 524             | 529         | NM          | (1)%        | NM          |
| Bath & Body Works                                      | 594             | 655         | 697         | (9)%        | (6)%        |
| <b><u>Sales per Average Store (in thousands)</u></b>   |                 |             |             |             |             |
| Victoria's Secret Stores                               | \$3,480         | \$3,678     | \$3,698     | (5)%        | (1)%        |
| La Senza (a) (b) (c)                                   | 1,551           | 1,619       | NM          | (4)%        | NM          |
| Bath & Body Works                                      | 1,410           | 1,540       | 1,613       | (8)%        | (5)%        |
| <b><u>Average Store Size (selling square feet)</u></b> |                 |             |             |             |             |
| Victoria's Secret Stores                               | 5,727           | 5,489       | 5,111       | 4%          | 7%          |
| La Senza (a) (c)                                       | 3,026           | 2,888       | NM          | 5%          | NM          |
| Bath & Body Works                                      | 2,378           | 2,370       | 2,331       | — %         | 2%          |
| <b><u>Total Selling Square Feet (in thousands)</u></b> |                 |             |             |             |             |
| Victoria's Secret Stores                               | 5,973           | 5,599       | 5,126       | 7%          | 9%          |
| La Senza (a) (c)                                       | 974             | 901         | 944         | 8%          | (5)%        |
| Bath & Body Works                                      | 3,895           | 3,773       | 3,604       | 3%          | 5%          |

(a) La Senza was acquired on January 12, 2007.

(b) Excluding the impact of currency fluctuations, sales per average selling square foot were flat for 2008 and sales per average store decreased 3% for 2008.

(c) Metric excludes independently owned La Senza stores operated by licensees.

NM Not meaningful

The following table compares 2008 store data to the comparable periods for 2007 and 2006:

|                              | <u>2008</u>  | <u>2007</u>  | <u>2006</u>  |
|------------------------------|--------------|--------------|--------------|
| <b>Number of Stores (a)</b>  |              |              |              |
| <b>Victoria's Secret</b>     |              |              |              |
| Beginning of Period          | 1,020        | 1,003        | 998          |
| Opened                       | 41           | 35           | 24           |
| Closed                       | (18)         | (18)         | (19)         |
| End of Period                | <u>1,043</u> | <u>1,020</u> | <u>1,003</u> |
| <b>La Senza (b)</b>          |              |              |              |
| Beginning of Period          | 312          | 291          | —            |
| Opened                       | 15           | 27           | —            |
| Closed                       | (5)          | (6)          | (2)          |
| Acquired                     | —            | —            | 293          |
| End of Period                | <u>322</u>   | <u>312</u>   | <u>291</u>   |
| <b>Bath &amp; Body Works</b> |              |              |              |
| Beginning of Period          | 1,592        | 1,546        | 1,555        |
| Opened                       | 80           | 67           | 20           |
| Closed                       | (34)         | (21)         | (29)         |
| End of Period                | <u>1,638</u> | <u>1,592</u> | <u>1,546</u> |
| <b>Apparel</b>               |              |              |              |
| Beginning of Period          | —            | 918          | 1,035        |
| Opened                       | —            | —            | 2            |
| Closed                       | —            | (49)         | (119)        |
| Divested (c)                 | —            | (869)        | —            |
| End of Period                | <u>—</u>     | <u>—</u>     | <u>918</u>   |

(a) Excludes Henri Bendel store locations (5 in 2008 and 2 in 2007 and 2006), Bath & Body Works Canada store locations (6 in 2008 and 0 in 2007 and 2006) and Diva London store locations (0 in 2008 and 2007 and 6 in 2006).

(b) Number of stores excludes independently owned La Senza stores operated by licensees.

(c) Represents stores related to the 75% divestitures of our ownership interests in Express and Limited Stores in July 2007 and August 2007, respectively.

## Results of Operations – 2008 Compared to 2007

### Operating Income

The following table provides our segment operating income (loss) and operating income rates (expressed as a percentage of net sales) for 2008 in comparison to 2007:

|                           | 2008          | 2007 (a)       | Operating Income Rate |              |
|---------------------------|---------------|----------------|-----------------------|--------------|
|                           |               |                | 2008                  | 2007         |
|                           | (in millions) |                |                       |              |
| Victoria's Secret (b) (c) | \$405         | \$ 718         | 7.2%                  | 12.8%        |
| Bath & Body Works         | 215           | 302            | 9.1%                  | 12.1%        |
| Apparel (d)               | —             | 250            | NA                    | 28.7%        |
| Other (e) (f) (g) (h)     | (31)          | (160)          | (2.9)%                | (13.7)%      |
| <b>Total</b>              | <b>\$589</b>  | <b>\$1,110</b> | <b>6.5%</b>           | <b>11.0%</b> |

- (a) Amounts presented are restated to conform with the corporate cost allocation methodology adopted at the beginning of 2008. For additional information, see Note 21 to the Consolidated Financial Statements included in Item 8. Financial Statements and Supplementary Data.
- (b) 2008 includes a \$215 million impairment charge related to goodwill and other intangible assets for the La Senza business. For additional information, see Critical Accounting Policies and Estimates and Note 10 to the Consolidated Financial Statements included in Item 8. Financial Statements and Supplementary Data.
- (c) 2007 includes \$48 million related to initial recognition of income for unredeemed gift cards for Victoria's Secret.
- (d) 2007 includes a \$230 million net gain related to the divestiture of Express and Limited Stores. For additional information, see Note 6 to the Consolidated Financial Statements included in Item 8. Financial Statements and Supplementary Data.
- (e) Includes Corporate, Mast, Henri Bendel and Bath & Body Works Canada.
- (f) 2008 includes a \$109 million net gain on joint ventures. For additional information, see Note 6 and Note 11 to the Consolidated Financial Statements included in Item 8. Financial Statements and Supplementary Data.
- (g) 2008 includes \$23 million of expense related to restructuring activities. For additional information, see Note 7 to the Consolidated Financial Statements included in Item 8. Financial Statements and Supplementary Data.
- (h) 2007 includes restructuring and impairment charges totaling \$53 million, which excludes both the \$6 million of net loss attributable to noncontrolling interest associated with the charges and \$25 million in gains related to the sale of corporate aircraft. For additional information, see Note 7 to the Consolidated Financial Statements included in Item 8. Financial Statements and Supplementary Data.
- NA Not applicable

For 2008, operating income decreased \$521 million to \$589 million and the operating income rate decreased to 6.5% from 11.0%. The drivers of the operating income results are discussed in the following sections.

## Net Sales

The following table provides net sales for 2008 in comparison to 2007:

|                          | <u>2008</u>    | <u>2007</u>     | <u>% Change</u> |
|--------------------------|----------------|-----------------|-----------------|
|                          | (in millions)  |                 |                 |
| Victoria's Secret Stores | \$3,590        | \$ 3,720        | (3)%            |
| La Senza (a)             | 491            | 488             | 1%              |
| Victoria's Secret Direct | 1,523          | 1,399           | 9%              |
| Total Victoria's Secret  | 5,604          | 5,607           | — %             |
| Bath & Body Works        | 2,374          | 2,494           | (5)%            |
| Express (b)              | NA             | 659             | NM              |
| Limited Stores (b)       | NA             | 211             | NM              |
| Total Apparel (b)        | NA             | 870             | NM              |
| Other (c)                | 1,065          | 1,163           | (8)%            |
| Total Net Sales          | <u>\$9,043</u> | <u>\$10,134</u> | <u>(11)%</u>    |

(a) La Senza includes a \$19 million decrease in net sales from 2007 to 2008 related to currency fluctuations.

(b) Express and Limited Stores were divested in July 2007 and August 2007, respectively.

(c) Other includes Corporate, Mast, Henri Bendel and Bath & Body Works Canada.

NA Not applicable

NM Not meaningful

The following tables provide a reconciliation of net sales for 2007 to 2008:

|   | <u>Victoria's<br/>Secret</u> | <u>Bath &amp;<br/>Body Works</u> | <u>Apparel</u>     | <u>Other</u>          | <u>Total</u>           |
|---|------------------------------|----------------------------------|--------------------|-----------------------|------------------------|
|   | (in millions)                |                                  |                    |                       |                        |
| <b>2007 Net Sales</b>   | <b>\$ 5,607</b>              | <b>\$ 2,494</b>                  | <b>\$ 870</b>      | <b>\$1,163</b>        | <b>\$10,134</b>        |
| Comparable Store Sales  | (289)                        | (212)                            | —                  | —                     | (501)                  |
| Sales Associated with New, Closed, Divested and Non-comparable Remodeled Stores,<br>Net (a) | 162                          | 73                               | (870)              | 14                    | (621)                  |
| Direct Channels   | 124                          | 19                               | —                  | —                     | 143                    |
| Mast Third-party Sales and Other  | —                            | —                                | —                  | (112)                 | (112)                  |
| <b>2008 Net Sales</b>   | <b><u>\$ 5,604</u></b>       | <b><u>\$ 2,374</u></b>           | <b><u>\$ —</u></b> | <b><u>\$1,065</u></b> | <b><u>\$ 9,043</u></b> |

(a) Victoria's Secret includes a \$19 million decrease in net sales at La Senza related to currency fluctuations.

The following table compares 2008 comparable store sales to 2007:

|                              | <u>2008</u> | <u>2007</u> |
|------------------------------|-------------|-------------|
| Victoria's Secret Stores     | (9)%        | (2)%        |
| La Senza                     | (3)%        | 6%          |
| Total Victoria's Secret      | (8)%        | (2)%        |
| Bath & Body Works            | (9)%        | (4)%        |
| Express (a)                  | NA          | 6%          |
| Limited Stores (a)           | NA          | 4%          |
| Total Apparel (a)            | NA          | 5%          |
| Henri Bendel                 | 1%          | 2%          |
| Total Comparable Store Sales | <u>(9)%</u> | <u>(2)%</u> |

(a) Reflects comparable store sales prior to the divestitures of Express and Limited Stores in July 2007 and August 2007, respectively.

NA Not applicable

For 2008, our net sales decreased 11% to \$9.043 billion and comparable store sales decreased 9%. The decrease in our net sales was primarily driven by the following:

#### ***Victoria's Secret***

For 2008, net sales remained relatively flat at \$5.604 billion and comparable store sales decreased 8%. The net sales result was primarily driven by:

- At Victoria's Secret Direct, net sales increased 9% driven by strong performance in certain categories including swimwear and dresses and the impact of the 2007 operational issues at the new distribution center;
- At La Senza, net sales increased slightly due to increased net sales to international licensees and new store growth mostly offset by unfavorable currency fluctuations;

Partially offset by:

- At Victoria's Secret Stores, net sales decreased across many categories primarily driven by a merchandise assortment that did not overcome the challenging economic environment and initial recognition of gift card breakage of \$48 million in 2007. The declines were partially offset by growth related to new and expanded stores and an increase in Pink.

The decrease in comparable store sales was primarily driven by declines in store traffic and transactions in addition to decreased units per sales transaction.

#### ***Bath & Body Works***

For 2008, net sales decreased 5% to \$2.374 billion and comparable store sales decreased 9%. Net sales decreased driven by weak store traffic and the challenging economic environment. From a category perspective, declines in Signature Collection were offset partially by increases in the Aromatherapy, True Blue Spa and home fragrance categories. The decrease in comparable store sales was primarily driven by declines in store traffic and lower average unit retail prices offset partially by an increase in merchandise units per transaction.

#### ***Apparel and Other***

For 2008, Apparel net sales decreased \$870 million as a result of the 2007 divestitures of 75% of our equity interests in Express and Limited Stores. In addition, Other net sales decreased \$98 million to \$1.065 billion primarily driven by a decrease in Mast sales as well as the personal care joint venture that was sold in the first quarter of 2008.

#### **Gross Profit**

For 2008, our gross profit decreased 14% to \$3.006 billion and our gross profit rate (expressed as a percentage of net sales) decreased to 33.2% from 34.6% primarily driven by the following:

#### ***Victoria's Secret***

For 2008, gross profit decreased primarily driven by the decrease at Victoria's Secret Stores in net sales and the related decrease in merchandise margin dollars combined with increased buying and occupancy expenses related to our new and remodeled stores.

Victoria's Secret Direct's gross profit remained relatively flat as the impact of the 9% increase in net sales was offset by the impact of increased promotional activity to clear inventory and an increase in catalogue circulation.

The gross profit rate decreased driven primarily by an increase in the buying and occupancy expense rate as cited above.

#### ***Bath & Body Works***

For 2008, gross profit decreased primarily driven by lower net sales and a related decrease in merchandise margin dollars combined with an increase in buying and occupancy expenses associated with store real estate activity.

The gross profit rate decreased driven primarily by an increase in the buying and occupancy expense rate due to the factors cited above.

#### ***Apparel and Other***

For 2008, gross profit decreased \$250 million as a result of the divestitures of 75% equity interest in Express and Limited Stores in 2007.

## General, Administrative and Store Operating Expenses

For 2008, our general, administrative and store operating expenses decreased 12% to \$2.311 billion primarily driven by:

- the Apparel divestitures in the second quarter of 2007;
- the elimination of costs related to the technology joint venture that was closed in December 2007;
- the elimination of costs related to the personal care joint venture that was sold in the first quarter of 2008; and
- expense reductions across all segments, primarily in home office costs.

Partially offset by:

- gains of \$25 million related to the sale of corporate aircraft in 2007.

The general, administrative and store operating expense rate decreased to 25.6% from 25.8% primarily driven by the factors cited above.

## Impairment of Goodwill and Other Intangible Assets

In the fourth quarter of 2008, we recognized charges totaling \$215 million related to the impairment of goodwill and trade name assets associated with our La Senza business. The impairment charges were based on our evaluation of the estimated fair value of the La Senza business and trade name assets as compared to their respective carrying values. Our evaluation concluded that as a result of the global economic downturn and the related negative impact on La Senza's operating performance, the fair value of the La Senza business and trade name assets were below their carrying values as of the fourth quarter of 2008. For additional information, see Critical Accounting Policies and Estimates and Note 10 to the Consolidated Financial Statements included in Item 8. Financial Statements and Supplemental Data.

## Net Gain on Joint Ventures

In April 2008, we and our investment partner completed the divestiture of a personal care joint venture to a third party. We recognized a pre-tax gain of \$128 million on the divestiture. The pre-tax gain is included in Net Gain on Joint Ventures on the 2008 Consolidated Statement of Income. In addition, we recorded a \$19 million impairment charge related to another joint venture. The charge consisted of writing down the investment balance, reserving certain accounts and notes receivable and accruing a contractual liability. The impairment of \$19 million is also included in Net Gain on Joint Ventures on the 2008 Consolidated Statement of Income.

## Apparel Divestitures

On July 6, 2007, we finalized the divestiture of a 75% ownership interest in our Express brand to affiliates of Golden Gate Capital for pre-tax net cash proceeds of \$547 million. The transaction resulted in a pre-tax gain on divestiture of \$302 million.

On August 3, 2007, we divested a 75% ownership interest of our Limited Stores business to affiliates of Sun Capital Partners. As part of the transaction, Sun Capital contributed \$50 million of equity capital into the business and arranged for a \$75 million credit facility. We received no cash proceeds from the transaction and recorded a pre-tax loss of \$72 million on the transaction.

## Other Income and Expenses

### Interest Expense

The following table provides the average daily borrowings and average borrowing rates for 2008 and 2007:

|   | <u>2008</u> | <u>2007</u> |
|---|-------------|-------------|
| Average daily borrowings (in millions)  | \$2,909     | \$2,408     |
| Average borrowing rate (in percentages) | 5.9%        | 6.2%        |

For 2008, interest expense increased \$32 million to \$181 million. The increase was primarily driven by an increase in average borrowings and an increase in fees related to our credit facilities partially offset by a decrease in the average borrowing rate.

### Interest Income

For 2008, our interest income remained flat at \$18 million as the impact of higher average invested cash balances was offset by a decrease in average effective interest rates.

## Other Income (Loss)

For 2008, other income (loss) decreased \$105 million to \$23 million due to a 2007 gain of \$100 million related to a distribution from Easton Town Center, LLC and net gains of \$17 million from the settlement of interest rate lock agreements in 2007. The other income decrease was partially offset by a \$71 million cash distribution from Express which resulted in a pre-tax gain of \$13 million in 2008.

## Provision for Income Taxes

For 2008, our effective tax rate increased to 51.5% from 36.4%. The increase in the rate resulted primarily from the 2008 impairment of goodwill and other intangible assets at La Senza, which is not deductible for income tax purposes.

## Net Income (Loss) Attributable to Noncontrolling Interest

For 2008, net loss attributable to noncontrolling interest decreased \$18 million to \$4 million. Net income (loss) attributable to noncontrolling interest represents the proportional share of net income or losses of consolidated, less than wholly owned subsidiaries attributable to the noncontrolling investor. The decrease is a result of the divestiture of a personal care joint venture in first quarter of 2008 and the closure of a technology joint venture in December 2007.

## Results of Operations – Fourth Quarter of 2008 Compared to Fourth Quarter of 2007

### Operating Income

The following table provides our segment operating income (loss) and operating income rates (expressed as a percentage of net sales) for the fourth quarter of 2008 in comparison to the fourth quarter of 2007:

|                           | Fourth Quarter |               | Operating Income Rate |         |
|---------------------------|----------------|---------------|-----------------------|---------|
|                           | 2008           | 2007 (a)      | 2008                  | 2007    |
|                           | (in millions)  |               |                       |         |
| Victoria's Secret (b) (c) | \$ (2)         | \$ 358        | (0.1)%                | 18.9%   |
| Bath & Body Works         | 209            | 296           | 21.0%                 | 27.3%   |
| Other (d) (e)             | (54)           | (33)          | (24.2)%               | (10.5)% |
| Total                     | <u>\$153</u>   | <u>\$ 621</u> | 5.1%                  | 19.0%   |

(a) Amounts presented are restated to conform with the corporate cost allocation methodology adopted at the beginning of 2008. For additional information, see Note 21 to the Consolidated Financial Statements included in Item 8. Financial Statements and Supplementary Data.

(b) 2008 includes a \$215 million impairment charge related to goodwill and other intangible assets for the La Senza business. For additional information, see Critical Accounting Policies and Estimates and Note 10 to the Consolidated Financial Statements included in Item 8. Financial Statements and Supplementary Data.

(c) 2007 includes \$48 million related to initial recognition of income for unredeemed gift cards for Victoria's Secret.

(d) Includes Corporate, Mast, Henri Bendel and Bath & Body Works Canada.

(e) 2008 includes \$23 million in restructuring charges. For additional information, see Note 7 to the Consolidated Financial Statements included in Item 8. Financial Statements and Supplementary Data.

For the fourth quarter of 2008, operating income decreased \$468 million to \$153 million and the operating income rate decreased to 5.1% from 19.0%. The drivers of the operating income results are discussed in the following sections.

## Net Sales

The following table provides net sales for the fourth quarter of 2008 in comparison to the fourth quarter of 2007:

|                          | <u>2008</u>    | <u>2007</u>    | <u>% Change</u> |
|--------------------------|----------------|----------------|-----------------|
|                          | (in millions)  |                |                 |
| <b>Fourth Quarter</b>    |                |                |                 |
| Victoria's Secret Stores | \$ 1,185       | \$ 1,294       | (8)%            |
| La Senza (a)             | 133            | 166            | (20)%           |
| Victoria's Secret Direct | 449            | 433            | 4%              |
| Total Victoria's Secret  | <u>1,767</u>   | <u>1,893</u>   | <u>(7)%</u>     |
| Bath & Body Works        | 998            | 1,080          | (8)%            |
| Other (b)                | 226            | 303            | (25)%           |
| Total Net Sales          | <u>\$2,991</u> | <u>\$3,276</u> | <u>(9)%</u>     |

(a) La Senza includes a \$31 million decrease in net sales from 2007 to 2008 related to currency fluctuations.

(b) Other includes Corporate, Mast, Beauty Avenues, Henri Bendel and Bath & Body Works Canada.

The following table provides a reconciliation of net sales for the fourth quarter of 2007 to the fourth quarter of 2008:

|  | <u>Victoria's<br/>Secret</u> | <u>Bath &amp;<br/>Body Works</u> | <u>Other</u>  | <u>Total</u>    |
|--|------------------------------|----------------------------------|---------------|-----------------|
|  | (in millions)                |                                  |               |                 |
| <b>Fourth Quarter</b>  |                              |                                  |               |                 |
| <b>2007 Net Sales</b>  | \$ 1,893                     | \$ 1,080                         | \$ 303        | \$ 3,276        |
| Comparable Store Sales   | (128)                        | (107)                            | (2)           | (237)           |
| Sales Associated With New, Closed, Divested and Non-comparable Remodeled Stores, Net (a) | (14)                         | 18                               | 11            | 15              |
| Direct Channels  | 16                           | 7                                | —             | 23              |
| Mast Third-party Sales and Other   | —                            | —                                | (86)          | (86)            |
| <b>2008 Net Sales</b>  | <u>\$ 1,767</u>              | <u>\$ 998</u>                    | <u>\$ 226</u> | <u>\$ 2,991</u> |

(a) Victoria's Secret includes a \$31 million decrease in net sales at La Senza related to currency fluctuations.

The following table compares fourth quarter of 2008 comparable store sales to fourth quarter of 2007:

|                              | <u>2008</u>  | <u>2007</u> |
|------------------------------|--------------|-------------|
| <b>Fourth Quarter</b>        |              |             |
| Victoria's Secret Stores     | (10)%        | (8)%        |
| La Senza                     | (10)%        | 6%          |
| Total Victoria's Secret      | (10)%        | (8)%        |
| Bath & Body Works            | (11)%        | (8)%        |
| Henri Bendel                 | (14)%        | 6%          |
| Total Comparable Store Sales | <u>(10)%</u> | <u>(8)%</u> |

For the fourth quarter of 2008, our net sales decreased 9% to \$2.991 billion and comparable store sales decreased 10%. The decrease in our net sales was primarily driven by the following:



### **Victoria's Secret**

For the fourth quarter of 2008, net sales decreased 7% to \$1.767 billion and comparable store sales decreased 10%. The decrease in net sales was primarily driven by:

- At Victoria's Secret Stores, net sales decreased across most categories primarily driven by a merchandise assortment that did not overcome the challenging economic environment and the initial recognition of gift card breakage of \$48 million in 2007. The declines were partially offset by growth related to new and expanded stores as well as an increase in Pink;
- At La Senza, net sales decreased due to unfavorable currency fluctuations and a merchandise assortment that did not overcome the challenging economic environment;

Partially offset by:

- At Victoria's Secret Direct, although sales were below our expectations due to the challenging economic environment, net sales increased 4% as we anniversaried the 2007 operational issues at the new distribution center which negatively impacted net sales in 2007.

The decrease in comparable store sales was primarily driven by declines in store traffic and lower average unit retail prices offset partially by an increase in merchandise units per transaction.

### **Bath & Body Works**

For the fourth quarter of 2008, net sales decreased 8% to \$998 million and comparable store sales decreased 11%. Net sales decreased across most merchandise categories as a result of the challenging economic environment. The decrease in comparable store sales was primarily driven by lower average unit retail prices and declines in store traffic.

### **Other**

For the fourth quarter of 2008, net sales decreased 25% to \$226 million. The decrease in net sales was primarily driven by a decrease in Mast sales as well as the personal care joint venture that was sold in the first quarter of 2008.

### **Gross Profit**

For the fourth quarter of 2008, our gross profit decreased 21% to \$1.024 billion and our gross profit rate (expressed as a percentage of net sales) decreased to 34.3% from 39.6% primarily driven by the following:

#### **Victoria's Secret**

For the fourth quarter of 2008, gross profit decreased primarily driven by:

- At Victoria's Secret Stores, gross profit decreased significantly driven by lower merchandise margin dollars as a result of the decline in net sales, including the impact of the initial recognition of gift card breakage in 2007, and increased promotional activity to drive sales and clear inventory. In addition, buying and occupancy expenses increased as a result of investments in our new and remodeled stores.
- At Victoria's Secret Direct, gross profit decreased as a result of a decline in merchandise margin associated with increased promotional activity. Additionally, buying and occupancy expenses increased due to higher catalogue circulation;
- At La Senza, gross profit decreased driven by a decrease in merchandise margin due to unfavorable currency fluctuations and a comparable store sales decrease of 10%.

The decrease in the gross profit rate was driven primarily by a decrease in the merchandise margin rate and an increase in the buying and occupancy expense rate due to the factors cited above.

#### **Bath & Body Works**

For the fourth quarter of 2008, gross profit decreased primarily driven by lower merchandise margin dollars as a result of a decline in net sales and an increase in promotional activity to drive sales and clear inventory. In addition, buying and occupancy expenses increased as a result of our store real estate activity.

The decrease in the gross profit rate was driven by a decrease in the merchandise margin rate and an increase in the buying and occupancy rate due to the factors cited above.

## General, Administrative and Store Operating Expenses

For the fourth quarter of 2008, our general, administrative and store operating expenses decreased 3% to \$656 million primarily driven by:

- the elimination of costs related to the technology joint venture that was closed in December 2007; and
- the elimination of costs related to the personal care joint venture that was sold in the first quarter of 2008.

Partially offset by:

- a restructuring charge of \$23 million consisting of severance and related costs in the fourth quarter of 2008.

The general, administrative and store operating expense rate increased to 21.9% from 20.6% primarily driven by the overall decline in sales during the fourth quarter of 2008.

## Impairment of Goodwill and Other Intangible Assets

In the fourth quarter of 2008, we recognized charges totaling \$215 million related to the impairment of goodwill and trade name assets associated with our La Senza business. The impairment charges were based on our evaluation of the estimated fair value of the La Senza business and trade name assets as compared to their respective carrying values. Our evaluation concluded that as a result of the global economic downturn and the related negative impact on La Senza's operating performance, the fair value of the La Senza business and trade name assets were below their carrying values as of the fourth quarter of 2008. For additional information, see Critical Accounting Policies and Estimates and Note 10 to the Consolidated Financial Statements included in Item 8. Financial Statements and Supplemental Data.

## Other Income and Expense

### Interest Expense

The following table provides the average daily borrowings and average borrowing rates for the fourth quarter of 2008 and 2007:

|   | <u>2008</u> | <u>2007</u> |
|---|-------------|-------------|
| <b>Fourth Quarter</b>                   |             |             |
| Average daily borrowings (in millions)  | \$2,900     | \$2,943     |
| Average borrowing rate (in percentages) | 5.9%        | 6.3%        |

For the fourth quarter of 2008, our interest expense decreased \$1 million to \$45 million. The decrease was primarily driven by a decrease in average borrowings and average borrowing rates offset partially by an increase in fees related to our credit facilities.

### Interest Income

For the fourth quarter of 2008, our interest income decreased \$4 million to \$2 million. The decrease was primarily driven by a decrease in average effective interest rates which was the result of our investment portfolio shift to U.S. government-backed securities.

### Other Income (Loss)

For the fourth quarter of 2008, our other income decreased \$10 million to \$0. The decrease was primarily driven by lower income from our equity investment in Express. We divested 75% of our equity interest in Express in July 2007 and retained the remaining 25% as an equity method investment.

### Provision for Income Taxes

For the fourth quarter of 2008, our effective tax rate increased to 85.4% from 34.2%. The increase in the rate resulted primarily from the impairment of goodwill and other intangible assets at La Senza, which is not deductible for income tax purposes.

## Results of Operations – 2007 Compared to 2006

### Operating Income

The following table provides our segment operating income (loss) and operating income rates (expressed as a percentage of net sales) for 2007 in comparison to 2006:

|                   | 2007 (a)       | 2006 (a)       | Operating Income Rate |              |
|-------------------|----------------|----------------|-----------------------|--------------|
|                   |                |                | 2007                  | 2006         |
|                   | (in millions)  |                |                       |              |
| Victoria's Secret | \$ 718         | \$ 879         | 12.8%                 | 17.1%        |
| Bath & Body Works | 302            | 420            | 12.1%                 | 16.4%        |
| Apparel           | 250            | (1)            | 28.7%                 | —            |
| Other (b)         | (160)          | (122)          | (13.7)%               | (16.8)%      |
| <b>Total</b>      | <b>\$1,110</b> | <b>\$1,176</b> | <b>11.0%</b>          | <b>11.0%</b> |

(a) Amounts presented are restated to conform with the corporate cost allocation methodology adopted at the beginning of 2008. For additional information, see Note 21 to the Consolidated Financial Statements included in Item 8. Financial Statements and Supplementary Data.

(b) Includes Corporate, Mast and Henri Bendel.

For 2007, operating income decreased \$66 million to \$1.110 billion and the operating income rate remained flat at 11.0%. The drivers of the operating income results are discussed in the following sections.

### Net Sales

The following table provides net sales for 2007 in comparison to 2006:

|                          | 2007            | 2006            | % Change    |
|--------------------------|-----------------|-----------------|-------------|
|                          | (in millions)   |                 |             |
| Victoria's Secret Stores | \$ 3,720        | \$ 3,700        | 1%          |
| La Senza (a)             | 488             | 23              | NM          |
| Victoria's Secret Direct | 1,399           | 1,416           | (1)%        |
| Total Victoria's Secret  | 5,607           | 5,139           | 9%          |
| Bath & Body Works        | 2,494           | 2,556           | (2)%        |
| Express (b)              | 659             | 1,749           | (62)%       |
| Limited Stores (b)       | 211             | 493             | (57)%       |
| Total Apparel (b)        | 870             | 2,242           | (61)%       |
| Other (c)                | 1,163           | 734             | 58%         |
| <b>Total Net Sales</b>   | <b>\$10,134</b> | <b>\$10,671</b> | <b>(5)%</b> |

(a) 2006 includes the results of La Senza from the date of acquisition, January 12, 2007.

(b) Includes the results of Express and Limited Stores prior to their divestitures in July 2007 and August 2007, respectively.

(c) Other includes Corporate, Mast, Beauty Avenues and Henri Bendel.

NM Not meaningful

The following tables provide a reconciliation of net sales for 2006 to 2007:

|   | <u>Victoria's<br/>Secret</u> | <u>Bath &amp;<br/>Body Works</u> | <u>Apparel</u><br>(in millions) | <u>Other</u>   | <u>Total</u>    |
|---|------------------------------|----------------------------------|---------------------------------|----------------|-----------------|
| <b>2006 Net Sales</b>   | \$ 5,139                     | \$ 2,556                         | \$ 2,242                        | \$ 734         | \$10,671        |
| Comparable Store sales  | (71)                         | (90)                             | 39                              | —              | (122)           |
| Sales Associated With New, Closed, Divested and Non-comparable Remodeled<br>Stores, Net | 45                           | 6                                | (1,411)                         | —              | (1,360)         |
| La Senza  | 465                          | —                                | —                               | —              | 465             |
| Direct Channels   | (19)                         | 22                               | —                               | —              | 3               |
| Initial Gift Card Breakage  | 48                           | —                                | —                               | —              | 48              |
| Mast Third-party Sales and Other  | —                            | —                                | —                               | 429            | 429             |
| <b>2007 Net Sales</b>   | <u>\$ 5,607</u>              | <u>\$ 2,494</u>                  | <u>\$ 870</u>                   | <u>\$1,163</u> | <u>\$10,134</u> |

The following table compares 2007 comparable store sales to 2006:

|                              | <u>2007</u> | <u>2006</u> |
|------------------------------|-------------|-------------|
| Victoria's Secret            | (2)%        | 11%         |
| Bath & Body Works            | (4)%        | 10%         |
| Express (a)                  | 6%          | (1)%        |
| Limited Stores (a)           | 4%          | (4)%        |
| Total Apparel (a)            | 5%          | (2)%        |
| Henri Bendel                 | 2%          | 1%          |
| Total Comparable Store Sales | <u>(2)%</u> | <u>7%</u>   |

(a) Reflects comparable store sales prior to the divestitures of Express and Limited Stores in July 2007 and August 2007, respectively.

For 2007, our net sales decreased 5% to \$10.134 billion and comparable store sales decreased 2%. The decrease in our net sales was primarily driven by the following:

#### **Victoria's Secret**

For 2007, net sales increased 9% to \$5.607 billion and comparable store sales decreased 2%. The increase in net sales was primarily driven by the inclusion of La Senza net sales for the full year in 2007. The decrease in comparable store sales was primarily driven by decreases across most categories, including core lingerie and beauty offset by modest increases in the Pink sub-brand and sleepwear. The decreases resulted from product assortment misses and a merchandise assortment that did not overcome the challenging economic environment in 2007.

#### **Bath & Body Works**

For 2007, net sales decreased 2% to \$2.494 billion and comparable store sales decreased 4%. The decrease in net sales and comparable store sales was primarily driven by declines in store traffic experienced throughout the year and, in particular, during the fourth quarter which resulted in disappointing holiday and semi-annual sale performance.

#### **Apparel**

For 2007, net sales decreased 61% to \$870 million as a result of the divestitures of Express and Limited Stores in the second quarter of 2007. Prior to the divestitures, comparable store sales increased 5%.

#### **Other**

For 2007, net sales increased by 58% to \$1.163 billion primarily driven by an increase in third-party customer sales at Mast due to the divestitures of Express and Limited Stores during the second quarter of 2007. Subsequent to the divestitures, 75% of Mast sales to Express and Limited Stores are included in third-party customer sales while the remaining 25% are eliminated consistent with our ownership interest.

## Gross Profit

For 2007, our gross profit decreased 13% to \$3.509 billion and our gross profit rate (expressed as a percentage of net sales) decreased to 34.6% from 37.6% primarily driven by the following:

### Victoria's Secret

For 2007, gross profit decreased primarily driven by the following:

- A decrease in gross profit at Victoria's Secret Stores driven primarily by increases in buying and occupancy expenses related to real estate expansion activities; and
- A decrease in gross profit at Victoria's Secret Direct driven primarily by the operational limitations affecting the new distribution center;

Partially offset by:

- Inclusion of La Senza's gross profit for the full year in 2007.

The gross profit rate decreased driven primarily by deleverage of buying and occupancy expenses and a decline in the merchandise margin rate associated with promotional activities and markdowns on certain categories in response to soft sales trends.

### Bath & Body Works

For 2007, gross profit decreased primarily driven by the decline in net sales. The gross profit rate decreased driven by a decline in the merchandise margin rate due to increased promotional activities designed to drive traffic.

### Apparel

For 2007, gross profit decreased as a result of the divestitures of Express and Limited Stores in the second quarter of 2007.

### General, Administrative and Store Operating Expenses

For 2007, our general, administrative and store operating expenses decreased 8% to \$2.616 billion primarily driven by the Apparel divestiture, cost reductions realized in the second half of the year associated with our second quarter restructuring program and gains from the sale of corporate aircraft. These decreases were partially offset by the charges recognized primarily in the second quarter of 2007 related to the restructuring program, increased costs at Victoria's Secret Direct related to the new distribution center and the inclusion of La Senza's general, administrative and store operating expenses for the full year in 2007. The general, administrative and store operating expense rate decreased to 25.8% from 26.6% primarily driven by the net impact of the Apparel divestiture, including the recognition of Mast net sales to Express and Limited Stores.

### Other Income and Expenses

#### Interest Expense

The following table provides the average daily borrowings and average borrowing rates for 2007 and 2006:

|   | 2007    | 2006    |
|---|---------|---------|
| Average daily borrowings (in millions)  | \$2,408 | \$1,711 |
| Average borrowing rate (in percentages) | 6.2%    | 5.9%    |

For 2007, interest expense increased \$47 million to \$149 million. The increase was primarily driven by an increase in average borrowings and average borrowing rates resulting from the issuance of \$1.0 billion of notes and borrowing an additional \$250 million under our amended term loan during the second quarter of 2007.

#### Interest Income

For 2007, interest income decreased \$7 million to \$18 million. The decrease was primarily driven by a decrease in average invested cash balances.

#### Other Income (Loss)

For 2007, other income (loss) increased \$131 million to \$128 million. The increase was primarily driven by a \$100 million gain related to a distribution from Easton Town Center, LLC ("ETC"), in which we have an equity investment, and income from our equity investment in Express. In July 2007, ETC refinanced its existing bank loan and distributed cash proceeds of \$150 million to its members. As an ETC member, we received approximately \$102 million of proceeds resulting in a \$100 million gain after

reducing our ETC carrying value from \$2 million to zero. In addition, we had a net gain of \$17 million from the settlement of interest rate lock agreements.

#### Provision for Income Taxes

For 2007, our effective tax rate decreased to 36.4% from 38.5%. The decline in the rate is primarily due to the reversal of state net operating loss carryforward valuation allowances in conjunction with the Apparel divestitures in the second quarter of 2007, a decline in the Canadian federal tax rate, audit settlements and other items.

#### Net Income (Loss) Attributable to Noncontrolling Interest

For 2007, net loss attributable to noncontrolling interest increased \$21 million to \$22 million. Net income (loss) attributable to noncontrolling interest represents the proportional share of net income or losses of consolidated, less than wholly owned subsidiaries attributable to the noncontrolling investor. The increase relates to losses from a personal care joint venture acquired during the first quarter of 2007 and losses from an investment in an independent technology company focused on large multi-channel retailers.

#### Results of Operations – Fourth Quarter of 2007 Compared to Fourth Quarter of 2006

##### Operating Income

The following table provides our segment operating income (loss) and operating income rates (expressed as a percentage of net sales) for the fourth quarter of 2007 in comparison to the fourth quarter of 2006:

|                   | Fourth Quarter |               | Operating Income Rate |              |
|-------------------|----------------|---------------|-----------------------|--------------|
|                   | 2007 (a)       | 2006 (a)      | 2007                  | 2006         |
|                   | (in millions)  |               |                       |              |
| Victoria's Secret | \$ 358         | \$ 380        | 18.9%                 | 20.4%        |
| Bath & Body Works | 296            | 324           | 27.3%                 | 27.6%        |
| Apparel           | NA             | 33            | NA                    | 4.5%         |
| Other (b)         | (33)           | (11)          | (10.5)%               | (4.7)%       |
| <b>Total</b>      | <b>\$ 621</b>  | <b>\$ 726</b> | <b>19.0%</b>          | <b>18.1%</b> |

(a) Amounts presented are restated to conform with the corporate cost allocation methodology adopted at the beginning of 2008. For additional information, see Note 21 to the Consolidated Financial Statements included in Item 8. Financial Statements and Supplementary Data.

(b) Includes Corporate, Mast and Henri Bendel.

For the fourth quarter of 2007, operating income decreased \$105 million to \$621 million and the operating income rate increased to 19.0% from 18.1%. The drivers of the operating income results are discussed in the following sections.

## Net Sales

The following table provides net sales for the fourth quarter of 2007 in comparison to the fourth quarter of 2006:

|                          | <u>2007</u>    | <u>2006</u>    | <u>% Change</u> |
|--------------------------|----------------|----------------|-----------------|
|                          | (in millions)  |                |                 |
| <b>Fourth Quarter</b>    |                |                |                 |
| Victoria's Secret Stores | \$ 1,294       | \$ 1,349       | (4)%            |
| La Senza (a)             | 166            | 23             | NM              |
| Victoria's Secret Direct | 433            | 492            | (12)%           |
| Total Victoria's Secret  | <u>1,893</u>   | <u>1,864</u>   | <u>2%</u>       |
| Bath & Body Works        | 1,080          | 1,175          | (8)%            |
| Express (b)              | —              | 589            | NM              |
| Limited Stores (b)       | —              | 155            | NM              |
| Total Apparel (b)        | <u>—</u>       | <u>744</u>     | <u>NM</u>       |
| Other (c)                | 303            | 242            | 25%             |
| Total Net Sales          | <u>\$3,276</u> | <u>\$4,025</u> | <u>(19)%</u>    |

(a) 2006 includes the results of La Senza from the date of acquisition, January 12, 2007.

(b) Express and Limited Stores were divested in July 2007 and August 2007, respectively.

(c) Other includes Corporate, Mast, Beauty Avenues and Henri Bendel.

NM Not meaningful

The following table provides a reconciliation of net sales for the fourth quarter of 2006 to the fourth quarter of 2007:

|  | <u>Victoria's<br/>Secret</u> | <u>Bath &amp;<br/>Body Works</u> | <u>Apparel</u> | <u>Other</u>  | <u>Total</u>    |
|--|------------------------------|----------------------------------|----------------|---------------|-----------------|
|  | (in millions)                |                                  |                |               |                 |
| <b>Fourth Quarter</b>  |                              |                                  |                |               |                 |
| <b>2006 Net Sales</b>  | \$ 1,864                     | \$ 1,175                         | \$ 744         | \$ 242        | \$ 4,025        |
| Comparable Store Sales   | (92)                         | (81)                             | —              | —             | (173)           |
| Sales Associated With New, Closed, Divested and Non-comparable Remodeled Stores, Net | (9)                          | (19)                             | (744)          | —             | (772)           |
| La Senza   | 143                          | —                                | —              | —             | 143             |
| Direct Channels  | (61)                         | 5                                | —              | —             | (56)            |
| Initial Gift Card Breakage   | 48                           | —                                | —              | —             | 48              |
| Mast Third-party Sales and Other   | —                            | —                                | —              | 61            | 61              |
| <b>2007 Net Sales</b>  | <u>\$ 1,893</u>              | <u>\$ 1,080</u>                  | <u>\$ —</u>    | <u>\$ 303</u> | <u>\$ 3,276</u> |

The following table compares fourth quarter of 2007 comparable store sales to fourth quarter of 2006:

|                              | <u>2007</u> | <u>2006</u> |
|------------------------------|-------------|-------------|
| <b>Fourth Quarter</b>        |             |             |
| Victoria's Secret            | (8)%        | 10%         |
| Bath & Body Works            | (8)%        | 9%          |
| Express (a)                  | —           | 3%          |
| Limited Stores (a)           | —           | (4)%        |
| Total Apparel (a)            | <u>—</u>    | <u>1%</u>   |
| Henri Bendel                 | 6%          | 7%          |
| Total Comparable Store Sales | <u>(8)%</u> | <u>8%</u>   |

(a) Express and Limited Stores were divested in July 2007 and August 2007, respectively.

For the fourth quarter of 2007, our net sales decreased 19% to \$3.276 billion and comparable store sales decreased 8%. The decrease in our net sales was primarily driven by the following:

#### ***Victoria's Secret***

For the fourth quarter of 2007, net sales increased 2% to \$1.893 billion and comparable store sales decreased 8%. The increase in net sales was primarily driven by:

- Inclusion of La Senza's net sales for the full quarter in 2007; and
- Initial recognition of gift card breakage at Victoria's Secret of \$48 million;

Offset partially by:

- A decrease at Victoria's Secret Direct as a result of the actions we undertook to constrain customer orders due to the operational issues associated with the new distribution center; and
- A decrease at Victoria's Secret Stores primarily related to the 53<sup>rd</sup> week included in 2006 results and a merchandise assortment that did not overcome the challenging economic environment in 2007.

The decrease in comparable store sales was primarily driven by decreases across most categories, including core lingerie and beauty, offset by modest increases in the Pink sub-brand and sleepwear. The decreases resulted from product assortment misses and a merchandise assortment that did not overcome the challenging economic environment during the fourth quarter of 2007.

#### ***Bath & Body Works***

For the fourth quarter of 2007, net sales decreased 8% to \$1.080 billion and comparable store sales decreased 8%. The decrease in net sales was primarily driven by:

- Softness in mall traffic and the overall economic environment;
- A lack of newness in product assortment; and
- Prolonged holiday discounting that negatively affected the performance of the semi-annual sale.

#### ***Other***

For the fourth quarter of 2007, net sales increased 25% to \$303 million primarily driven by an increase in third-party customer sales at Mast due to the divestitures of Express and Limited Stores during the second quarter of 2007. Subsequent to the divestitures, 75% of Mast sales to Express and Limited Stores are included in third-party customer sales while the remaining 25% are eliminated in consolidation consistent with our ownership interest.

#### **Gross Profit**

For the fourth quarter of 2007, our gross profit decreased 20% to \$1.296 billion and our gross profit rate (expressed as a percentage of net sales) decreased to 39.6% from 40.1% primarily driven by the following:

#### ***Victoria's Secret***

For the fourth quarter of 2007, gross profit decreased primarily driven by:

- A decrease in merchandise margin at Victoria's Secret Direct due to the actions we undertook to constrain customer orders; and
- A decrease in merchandise margin associated with decreased net sales at Victoria's Secret Stores and increased buying and occupancy expenses associated with the real estate expansion activities;

Offset partially by:

- Initial recognition of gift card breakage of \$48 million; and
- Inclusion of La Senza's gross profit for the full quarter in 2007.

The gross profit rate decreased driven primarily by deleverage of buying and occupancy expenses due to the Victoria's Secret Stores real estate expansion activities and inclusion of La Senza's results for the full quarter in 2007.

#### ***Bath & Body Works***

For the fourth quarter of 2007, gross profit decreased primarily driven by lower net sales. The gross profit rate decreased driven by a modest decline in the merchandise margin rate related to promotional activity to clear seasonal merchandise and deleverage in the buying and occupancy expense rate associated with the decline in net sales.



## General, Administrative and Store Operating Expenses

For the fourth quarter of 2007, our general, administrative and store operating expenses decreased 24% to \$675 million primarily driven by the Apparel divestitures. The general, administrative and store operating expense rate decreased to 20.6% from 22.0% primarily driven by the net impact of the Apparel divestitures, including the recognition of Mast net sales to Express and Limited Stores. The rate also benefited from the initial recognition of gift card breakage at Victoria's Secret and lower incentive compensation and marketing expense.

## Other Income and Expense

### Interest Expense

The following table provides the average daily borrowings and average borrowing rates for the fourth quarter of 2007 and 2006:

|   | <u>2007</u> | <u>2006</u> |
|---|-------------|-------------|
| <b>Fourth Quarter</b>                   |             |             |
| Average daily borrowings (in millions)  | \$2,943     | \$1,776     |
| Average borrowing rate (in percentages) | 6.3%        | 5.9%        |

For the fourth quarter of 2007, our interest expense increased \$18 million to \$46 million. The increase was primarily driven by an increase in average borrowings and average borrowing rates resulting from the issuance of \$1.0 billion of notes and borrowing an additional \$250 million under our amended term loan during the second quarter of 2007.

### Interest Income

For the fourth quarter of 2007, our interest income increased \$2 million to \$6 million. The increase was primarily driven by an increase in average invested cash balances partially offset by a decrease in average effective interest rates.

### Other Income (Loss)

For the fourth quarter of 2007, our other income (loss) increased \$9 million to \$10 million. The increase was primarily driven by income from our equity investment in Express. We divested 75% of Express in July 2007 and retained the remaining 25% as an equity method investment.

### Provision for Income Taxes

For the fourth quarter of 2007, our effective tax rate decreased to 34.2% from 37.7%. The decline in the rate resulted from a decline in the Canadian federal tax rate, the finalization of income taxes related to the Apparel divestitures, audit settlements and other items.

## FINANCIAL CONDITION

### Liquidity and Capital Resources

Liquidity, or access to cash, is an important factor in determining our financial stability. We are committed to maintaining adequate liquidity. Cash generated from our operating activities provides the primary resources to support current operations, growth initiatives, seasonal funding requirements and capital expenditures. Our cash provided from operations is impacted by working capital changes and our net income. Our net income is impacted by, among other things, sales volume, seasonal sales patterns, timing of new product introductions and profit margins. Historically, sales are higher during the fourth quarter of the fiscal year due to seasonal and holiday-related sales patterns. Generally, our need for working capital peaks during the summer and fall months as inventory builds in anticipation of the holiday period.

As of January 31, 2009, we had total revolving credit facilities of \$1.3 billion including a \$1 billion, 5-year facility that expires in August 2012 (the "5-Year Facility") and a \$300 million, 364-day facility that was set to expire in July 2009 (the "364-Day Facility"). The facilities contain fixed charge coverage and leverage covenants that may limit the availability of the facilities. Both facilities support our commercial paper and letter of credit programs. We did not borrow under either of the facilities in 2008.

On February 19, 2009, we amended the 5-Year Facility and the \$750 million term loan maturing in August 2012 ("Term Loan") and we canceled the 364-Day Facility after determining it was no longer required. The amendment to the 5-Year Facility and the Term Loan includes changes to both the fixed charge coverage and leverage covenants which provide additional flexibility. Under the amended covenants, we are required to maintain the fixed charge coverage ratio at 1.60 or above through fiscal year 2010 and 1.75 or above thereafter. The leverage ratio, which is debt compared to EBITDA, as those terms are defined in the agreement, must not exceed 5.0 through the third quarter of fiscal year 2010, 4.5 from the fourth quarter of fiscal year 2010 through the third quarter of fiscal year 2011 and 4.0 thereafter. The amendment also increases the interest costs and fees associated with the 5-Year Facility and the Term Loan, provides for certain security interests as defined in the agreement and limits dividends, share repurchases and other restricted payments as defined in the agreement to \$220 million per year with certain potential increases as defined in the agreement. The interest rate as of January 31, 2009 on the Term Loan would have been 6.69% had the amendment been effective at that date. The amendment does not impact the maturity dates of either the 5-Year Facility or the Term Loan.

The U.S. retail sector and our business have faced a very difficult environment during most of 2008 and into 2009. However, we believe that available short-term and long-term capital resources are sufficient to fund foreseeable requirements.

The following table provides a summary of our working capital position and capitalization as of January 31, 2009, February 2, 2008 and February 3, 2007:

|  | <u>January 31,<br/>2009</u> | <u>February 2,<br/>2008</u><br><small>(in millions)</small> | <u>February 3,<br/>2007</u> |
|--|-----------------------------|---|-----------------------------|
| Cash Provided by Operating Activities                    | \$ 954                      | \$ 765  | \$ 600                      |
| Capital Expenditures                                     | 479                         | 749   | 548                         |
| Working Capital  | 1,612                       | 1,545   | 1,062                       |
| Capitalization:  |                             |   |                             |
| Long-term Debt   | 2,897                       | 2,905   | 1,665                       |
| Shareholders' Equity                                     | 1,874                       | 2,219   | 2,955                       |
| Total Capitalization                                     | 4,771                       | 5,124   | 4,620                       |
| Additional Amounts Available Under Credit Agreements (a) | 1,300                       | 1,500   | 1,000                       |

(a) On February 19, 2009, we cancelled the 364-Day Facility, thereby reducing the amount available under credit agreements to \$1 billion as of that date.

The following table provides certain measures of liquidity and capital resources as of January 31, 2009, February 2, 2008 and February 3, 2007:

|                                     | January 31,<br>2009 | February 2,<br>2008 | February 3,<br>2007 |
|-------------------------------------|---------------------|---------------------|---------------------|
| Debt-to-equity Ratio (a)            | 155%                | 131%                | 56%                 |
| Debt-to-capitalization Ratio (b)    | 61%                 | 57%                 | 36%                 |
| Cash Flow to Capital Investment (c) | 199%                | 102%                | 109%                |

- (a) Long-term debt divided by shareholders' equity
- (b) Long-term debt divided by total capitalization
- (c) Net cash provided by operating activities divided by capital expenditures

### Credit Ratings

The following table provides our credit ratings as of January 31, 2009:

|                       | Moody's (a) | S&P (b) | Fitch    |
|-----------------------|-------------|---------|----------|
| Corporate             | Ba1         | BB+     | BB+      |
| Senior Unsecured Debt | Ba1         | BB+     | BB+      |
| Outlook               | Stable      | Stable  | Negative |

- (a) In November 2008, Moody's Investors Service ("Moody's") downgraded our Corporate and Senior Unsecured Debt ratings from an investment grade rating of Baa3 to a speculative grade rating of Ba1. In addition, Moody's changed their rating outlook to stable from negative.
- (b) In December 2008, Standard and Poor's ("S&P") downgraded our Corporate and Senior Unsecured Debt ratings from an investment grade rating of BBB- to a speculative grade rating of BB+. In addition, S&P changed their rating outlook to stable from negative.

Our borrowing costs and certain other provisions under our Term Loan and revolving credit facilities are linked to our credit ratings. As a result of the Moody's and S&P downgrades, our borrowing costs under our term loan and revolving credit facilities increased in the fourth quarter of 2008. The impact of this increase was not material to our earnings and cash flows in the fourth quarter of 2008. The Moody's or S&P downgrades did not accelerate the repayment of any of our debt.

The following table provides an update of our credit ratings as of March 20, 2009:

|                       | Moody's (a) | S&P (b)  | Fitch (c) |
|-----------------------|-------------|----------|-----------|
| Corporate             | Ba1         | BB       | BB+       |
| Senior Unsecured Debt | Ba2         | BB       | BB        |
| Outlook               | Negative    | Negative | Negative  |

- (a) In February 2009, Moody's downgraded our Senior Unsecured Debt ratings from a rating of Ba1 to Ba2. In addition, Moody's changed their rating outlook to negative from stable.
- (b) In February 2009, S&P downgraded our Corporate and Senior Unsecured Debt ratings from a rating of BB+ to BB. In addition, S&P changed their rating outlook to negative from stable.
- (c) In February 2009, Fitch downgraded our Senior Unsecured Debt from a rating of BB+ to BB.

The downgrades by the rating agencies in February 2009 will further increase our borrowing costs in 2009.

If we receive an additional downgrade in our credit ratings by any agencies listed above, the availability of additional credit could be negatively affected. Credit rating downgrades by any of the agencies do not accelerate the repayment of any of our debt.

### Common Stock Share Repurchases

In October 2008, our Board of Directors authorized management to repurchase \$250 million of our outstanding common stock. During November 2008, we repurchased 5.0 million shares of our common stock for \$43 million at an average price per share of approximately \$8.64. Through March 20, 2009, no additional shares were repurchased.

### Dividend Policy and Procedures

We currently pay a common stock dividend of \$0.15 per share in cash each quarter. Our Board of Directors will determine future dividends after giving consideration to our levels of profit and cash flow, capital requirements, current and forecasted liquidity, the restrictions placed upon us by our borrowing arrangements as well as financial and other business conditions existing at the time.

## Cash Flow

The following table provides a summary of our cash flow activity for the fiscal years ended January 31, 2009, February 2, 2008 and February 3, 2007:

|  | <u>2008</u>    | <u>2007</u><br>(in millions) | <u>2006</u>   |
|--|----------------|------------------------------|---------------|
| Cash and Cash Equivalents, Beginning of Year               | \$1,018        | \$ 500                       | \$ 1,208      |
| Net Cash Flows Provided by Operating Activities            | 954            | 765                          | 600           |
| Net Cash Flows (Used For) Provided by Investing Activities | (240)          | 30                           | (1,093)       |
| Net Cash Flows Used For Financing Activities               | (562)          | (279)                        | (215)         |
| Effect of Exchange Rate Changes on Cash                    | 3              | 2                            | —             |
| Net Increase (Decrease) in Cash and Cash Equivalents       | <u>155</u>     | <u>518</u>                   | <u>(708)</u>  |
| Cash and Cash Equivalents, End of Year                     | <u>\$1,173</u> | <u>\$1,018</u>               | <u>\$ 500</u> |

### Operating Activities

Net cash provided by operating activities in 2008 was \$954 million. Net income of \$216 million included (a) \$343 million of depreciation and amortization, (b) a \$215 million impairment of goodwill and other intangible assets and (c) a \$109 million net gain on joint ventures. Other changes in assets and liabilities represent items that had a current period cash flow impact, such as changes in working capital. The most significant working capital change was a \$103 million increase in operating cash flow associated with accounts receivable due primarily to reduced sourcing and other transition services billings to Express and Limited Stores.

Net cash provided by operating activities in 2007 was \$765 million consisting primarily of net income of \$696 million. Net income included (a) \$352 million of depreciation and amortization, (b) the \$302 million gain on divestiture of Express, and (c) the \$100 million gain on distribution from Easton Town Center, LLC. Other changes in assets and liabilities represent items that had a current period cash flow impact, such as changes in working capital. The most significant working capital change was a \$337 million increase in operating cash flow associated with inventories. Inventory levels decreased compared to 2006 due to a concerted effort to control and reduce inventory levels across the enterprise and due to reductions in safety stocks at Bath & Body Works that increased during 2006 in connection with the 2006 supply chain system conversion. Accounts receivable increased due to the Apparel divestitures, which caused Mast's accounts receivable from Express and Limited Stores to be recognized as third-party receivables on our balance sheet.

Net cash provided by operating activities in 2006 was \$600 million consisting primarily of net income of \$675 million. Net income included \$316 million of depreciation and amortization. Other changes in assets and liabilities represent items that had a current period cash flow impact, such as changes in working capital. The most significant working capital change was a \$545 million decrease in operating cash flow associated with inventories. We increased inventory levels during the year to meet the following objectives: (a) at Victoria's Secret, increases related to new product launches in core lingerie and beauty, initiatives to increase market share and build brand loyalty and an initiative to improve in-stock inventory positions and (b) at Bath & Body Works, increases related primarily to investments in safety stocks of seasonless basics in anticipation of the supply chain system conversion that occurred mid-year as well as an initiative to improve in-stock inventory positions.

### Investing Activities

Net cash used for investing activities in 2008 was \$240 million consisting primarily of \$479 million of capital expenditures offset by \$159 million from the divestiture of a joint venture and \$95 million from returns of capital from Express. The capital expenditures included \$345 million for opening new stores and remodeling and improving existing stores. Remaining capital expenditures were primarily related to spending on technology and infrastructure to support growth.

Net cash provided by investing activities in 2007 was \$30 million consisting primarily of (a) \$547 million of proceeds from the divestiture of Express, (b) \$102 million of proceeds from a distribution from Easton Town Center, LLC, and (c) \$97 million of proceeds related to the sale of assets, offset by \$749 million of capital expenditures. The capital expenditures included \$476 million for opening new stores and remodeling and improving existing stores. Remaining capital expenditures were primarily related to investments in our new distribution center and increased spending on home office, technology and infrastructure.

Net cash used for investing activities in 2006 was \$1.093 billion consisting primarily of \$572 million related to the acquisition of La Senza and \$548 million of capital expenditures. The capital expenditures included \$311 million for opening new stores and remodeling and improving existing stores. Remaining capital expenditures were primarily related to investments in new growth concepts and increased spending on technology and infrastructure to support growth.

We anticipate spending approximately \$200 million for capital expenditures in 2009 with the majority relating to opening new stores and remodeling and improving existing stores. We expect to open approximately 50 new stores in the U.S. and Canada and to close approximately 70 stores. Our new stores will be primarily Bath & Body Works and Victoria's Secret.

### Financing Activities

Net cash used for financing activities in 2008 was \$562 million consisting primarily of (a) cash payments of \$379 million related to the repurchase of 28 million shares of common stock during the year at a weighted-average price of \$13.36 under our November 2007 and October 2008 share repurchase programs and (b) quarterly dividend payments of \$0.15 per share, or \$201 million. These uses of cash were partially offset by the exercise of stock options of \$31 million.

Net cash used for financing activities in 2007 was \$279 million consisting primarily of (a) cash payments of \$1.4 billion related to the repurchase of 59 million shares of common stock during the year at a weighted-average price of \$24.01 under our June 2006, June 2007, August 2007 and November 2007 share repurchase programs and (b) quarterly dividend payments of \$0.15 per share, or \$227 million. These uses of cash were partially offset by (a) debt offering proceeds of \$997 million, (b) proceeds from the term loan refinancing of \$250 million and (c) the exercise of stock options of \$74 million.

Net cash used for financing activities in 2006 was \$215 million consisting primarily of (a) cash payments of \$193 million related to the repurchase of 8 million shares of common stock during the year at a weighted-average price of \$24.98 under our November 2005, February 2006 and June 2006 share repurchase programs and (b) quarterly dividend payments of \$0.15 per share, or \$238 million. These uses of cash were partially offset by proceeds from the exercise of stock options of \$153 million and excess tax benefits on share-based compensation of \$46 million.

### Contingent Liabilities and Contractual Obligations

The following table provides our contractual obligations, aggregated by type, including the maturity profile as of January 31, 2009:

|                                  | Payments Due by Period |                  |                |                |                   | Other        |
|----------------------------------|------------------------|------------------|----------------|----------------|-------------------|--------------|
|                                  | Total                  | Less Than 1 Year | 1-3 Years      | 4-5 Years      | More than 5 Years |              |
| Long-term Debt (a)               | \$ 4,905               | \$ 174           | \$ 348         | \$ 1,328       | \$ 3,055          | \$ —         |
| Operating Leases Obligations (b) | 3,400                  | 478              | 872            | 716            | 1,334             | —            |
| Purchase Obligations (c)         | 1,371                  | 1,194            | 65             | 112            | —                 | —            |
| Other Liabilities (d)            | 369                    | 26               | 24             | 3              | —                 | 316          |
| <b>Total</b>                     | <b>\$10,045</b>        | <b>\$ 1,872</b>  | <b>\$1,309</b> | <b>\$2,159</b> | <b>\$ 4,389</b>   | <b>\$316</b> |

- (a) Long-term debt obligations relate to our principal and interest payments for outstanding notes, debentures, Term Loan and line of credit borrowings. Interest payments have been estimated based on the coupon rate for fixed rate obligations and the variable rate, including the impact of the participating interest rate swap arrangement, in effect as of January 31, 2009 for the Term Loan. Interest obligations exclude amounts which have been accrued through January 31, 2009. For additional information, see the Notes to the Consolidated Financial Statements included in Item 8. Financial Statements and Supplementary Data.
- (b) Operating lease obligations primarily represent minimum payments due under store lease agreements. For additional information, see Note 16 to the Consolidated Financial Statements included in Item 8. Financial Statements and Supplementary Data.
- (c) Purchase obligations primarily include purchase orders for merchandise inventory and other agreements to purchase goods or services that are enforceable and legally binding and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transactions.
- (d) Other liabilities primarily includes future payments relating to our nonqualified supplemental retirement plan and have been reflected under "Other" as the timing of these future payments is not known until an associate leaves the company or otherwise requests an in-service distribution. In addition, Other Liabilities also includes future estimated payments associated with unrecognized tax benefits as accounted for under Financial Accounting Standards Board Interpretation 48, *Accounting for Uncertainty in Income Taxes*. The "Less Than 1 Year" category includes \$14 million because it is reasonably possible that the payments could change in the next twelve months due to audit settlements of resolution or uncertainties. The remaining portion is included in the "Other" category as the timing and amount of these payments is not

known until the matters are resolved with relevant tax authorities. For additional information, see Notes to the Consolidated Financial Statements in Item 8. Financial Statements and Supplementary Data.

In connection with the disposition of certain businesses, we have remaining guarantees of approximately \$194 million related to lease payments of Express, Limited Stores, Abercrombie & Fitch, Tween Brands (formerly Limited Too and Too, Inc.), Dick's Sporting Goods (formerly Galyan's), Lane Bryant, New York & Company and Anne.x under the current terms of noncancelable leases expiring at various dates through 2019. These guarantees include minimum rent and additional payments covering taxes, common area costs and certain other expenses and relate to leases that commenced prior to the disposition of the businesses. In certain instances, our guarantee may remain in effect if the term of a lease is extended.

The following table details the guaranteed lease payments during the next five fiscal years and the remaining years thereafter:

| <u>Fiscal Year (in millions)</u> |              |
|----------------------------------|--------------|
| 2009                             | \$ 48        |
| 2010                             | 39           |
| 2011                             | 30           |
| 2012                             | 24           |
| 2013                             | 22           |
| Thereafter                       | 31           |
| Total                            | <u>\$194</u> |

In April 2008, we received an irrevocable standby letter of credit from Express of \$34 million issued by a third-party bank to mitigate a portion of our contingent liability for guaranteed future lease payments of Express. We can draw from the irrevocable standby letter of credit if Express were to default on any of the guaranteed leases. The irrevocable standby letter of credit is reduced through September 30, 2010, the expiration date of the letter of credit, consistent with the overall reduction in guaranteed lease payments. The outstanding balance of the irrevocable standby letter of credit from Express was \$19 million as of January 31, 2009.

Our guarantees related to Express, Limited Stores and New York & Company are subject to the provisions of SFAS 145, *Rescission, Amendment and Technical Correction of Certain Accounting Standards*, which requires fair value accounting for these guarantee obligations. The guaranteed lease payments related to Express (net of the irrevocable standby letter of credit), Limited Stores and New York & Company totaled \$94 million and \$180 million as of January 31, 2009 and February 2, 2008, respectively. The estimated fair value of these guarantee obligations was \$15 million and \$10 million as of January 31, 2009 and February 2, 2008, respectively, and is included in Other Long-term Liabilities on our Consolidated Balance Sheets. The increase in the fair value from February 2, 2008 to January 31, 2009 reflects the impact of the current economic environment and our assessment of the risk of default on the guaranteed lease payments.

Our guarantees related to Abercrombie & Fitch, Tween Brands (formerly Limited Too and Too, Inc.), Dick's Sporting Goods (formerly Galyan's), Lane Bryant and Anne.x are not subject to the fair value provisions of SFAS 145 because they were executed prior to the effective date of SFAS 145. These guarantees are subject to the provisions of SFAS 5, *Accounting for Contingencies*, which requires that a loss be accrued when probable and reasonably estimable. As of January 31, 2009 and February 2, 2008, we had no liability recorded with respect to any of the guarantee obligations subject to SFAS 5 as we concluded that performance under these guarantees was not probable.

#### **Off Balance Sheet Arrangements**

We have no off balance sheet arrangements as defined by Regulation 229.303 Item 303 (a) (4).

#### **Recently Issued Accounting Pronouncements**

##### *SFAS 161, Disclosures about Derivative Instruments and Hedging Activities ("SFAS 161")*

In March 2008, the Financial Accounting Standards Board ("FASB") issued SFAS 161, which requires disclosures about the fair value of derivative instruments and their gains or losses in tabular format as well as disclosures regarding credit-risk-related contingent features in derivative agreements, counterparty credit risk and strategies and objectives for using derivative instruments. SFAS 161 amends and expands SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*, and is effective prospectively beginning in 2009. Adoption of SFAS 161 will impact our disclosures about derivative instruments and hedging activities beginning in 2009.

##### *SFAS 141, (revised 2007) Business Combinations ("SFAS 141(R)")*

In December 2007, the FASB issued SFAS 141(R), which establishes how the acquiring entity recognizes and measures the assets acquired, liabilities assumed, any gain on bargain purchases and any noncontrolling interest in the acquired entity. SFAS 141(R) requires acquisition-related costs to be expensed in the periods they are incurred, with the exception of the costs to issue debt or equity securities. SFAS 141(R) requires disclosure of information for a business combination that occurs during the accounting period or prior to the issuance of the financial statements for the accounting period. SFAS 141(R) is effective prospectively for business combinations with an acquisition date on or after the beginning of the first annual reporting period after December 15, 2008. Adoption of SFAS 141(R) is not expected to have an impact to our financial statements.

#### *SFAS 160, Noncontrolling Interests in Consolidated Financial Statements (“SFAS 160”)*

In December 2007, the FASB issued SFAS 160, which modifies reporting for noncontrolling interest (minority interest) in consolidated financial statements. SFAS 160 requires noncontrolling interest be reported in equity and establishes a new framework for recognizing net income or loss and comprehensive income by the controlling interest. SFAS 160 requires specific disclosures regarding changes in equity interest of both the controlling and noncontrolling parties and presentation of the noncontrolling equity balance and income or loss for all periods presented. SFAS 160 is effective for interim and annual periods in fiscal years beginning after December 15, 2008.

Upon adoption, prior period financial statements were recast for the presentation of the noncontrolling interest consistent with the retrospective application required by SFAS 160. The impact of the retrospective application of this standard is as follows:

- Reclassifies Minority Interest to Net Income (Loss) Attributable to Noncontrolling Interest on the Consolidated Statements of Income;
- Reclassifies Minority Interest to Noncontrolling Interest within the Total Equity section on the Consolidated Balance Sheets;
- Includes changes in Noncontrolling Interest in the Consolidated Statements of Total Equity; and
- Reclassifies Minority Interest to Net Income on the Consolidated Statements of Cash Flow.

In addition, we adjusted references to these items in Item 6. Selected Financial Data and Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

#### *SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities (“SFAS 159”)*

In February 2007, the FASB issued SFAS 159 permitting entities to choose to measure many financial instruments and certain other items at fair value. The standard also establishes presentation and disclosure requirements designed to facilitate comparison between entities that choose different measurement attributes for similar types of assets and liabilities. If the fair value option is elected, the effect of the first remeasurement to fair value is reported as a cumulative effect adjustment to the opening balance of retained earnings. The statement is applied prospectively upon adoption. We did not adopt fair value treatment for any assets or liabilities under SFAS 159 as of the beginning of 2008.

#### *SFAS 157, Fair Value Measurements (“SFAS 157”)*

In September 2006, the FASB issued SFAS 157, which provides guidance for fair value measurement of assets and liabilities and instruments measured at fair value. The statement defines fair value, establishes a fair value measurement framework and expands fair value disclosures. It emphasizes that fair value is market-based with the highest measurement hierarchy level being market prices in active markets. The standard requires fair value measurements be disclosed by hierarchy level, an entity include its own credit standing in the measurement of its liabilities and modifies the transaction price presumption.

In February 2008, the FASB issued FSP FAS 157-2, *Effective Date of FASB Statement 157* which delays the effective date of SFAS 157 to fiscal years beginning after November 15, 2008 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The provision of SFAS 157 is applied prospectively. We adopted the required portions of SFAS 157 at the beginning of 2008 which did not have a material impact to our financial statements. Adoption of the portions of SFAS 157 within the scope of FSP FAS 157-2 will not have a material impact on our financial statements beginning in 2009.

#### *Future Accounting Changes*

The FASB’s standard-setting process is ongoing and until new standards have been finalized and issued by FASB, we cannot determine the impact on the reporting of our operations and financial position that may result from any such future changes. The FASB is currently working on several projects including, but not limited to, revenue recognition, liabilities and equity, derivatives disclosures, earnings per share calculations and leases. We are also monitoring the potential adoption of International Financial Reporting Standards in the U.S. The ultimate pronouncements resulting from these and future projects could have an impact on our future results of operations and financial position.

## **Impact of Inflation**

While it is difficult to accurately measure the impact of inflation due to the imprecise nature of the estimates required, we believe the effects of inflation, if any, on the results of operations and financial condition have been minor.

## **Critical Accounting Policies and Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to adopt accounting policies related to estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of net sales and expenses during the reporting period, as well as the related disclosure of contingent assets and liabilities at the date of the financial statements. On an ongoing basis, management evaluates its accounting policies, estimates and judgments, including those related to inventories, long-lived assets, claims and contingencies, income taxes and revenue recognition. Management bases its estimates and judgments on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates. Management has discussed the development and selection of its critical accounting policies and estimates with the Audit Committee of its Board of Directors and believes the following assumptions and estimates are most significant to reporting its results of operations and financial position.

### **Inventories**

Inventories are principally valued at the lower of cost or market, on a weighted-average cost basis.

We record valuation adjustments to our inventories if the cost of specific inventory items on hand exceeds the amount we expect to realize from the ultimate sale or disposal of the inventory. These estimates are based on management's judgment regarding future demand and market conditions and analysis of historical experience. If actual demand or market conditions are different than those projected by management, future period merchandise margin rates may be unfavorably or favorably affected by adjustments to these estimates.

We also record inventory loss adjustments for estimated physical inventory losses that have occurred since the date of the last physical inventory. These estimates are based on management's analysis of historical results and operating trends.

Management does not believe that the assumptions used in these estimates will change significantly based on prior experience. A 10% increase or decrease in the inventory valuation adjustment would have impacted net income by approximately \$6 million for 2008. A 10% increase or decrease in the estimated physical inventory loss adjustment would have impacted net income by approximately \$2 million for 2008.

### **Valuation of Long-lived Assets**

Property and equipment and intangible assets with finite lives are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. If the estimated undiscounted future cash flows related to the asset are less than the carrying value, we recognize a loss equal to the difference between the carrying value and the fair value, usually determined by the estimated discounted future cash flows of the asset. Factors used in the valuation include, but are not limited to, management's plans for future operations, brand initiatives, recent operating results and projected future cash flows. When a decision has been made to dispose of property and equipment prior to the end of the previously estimated useful life, depreciation estimates are revised to reflect the use of the asset over the shortened estimated useful life.

Goodwill is reviewed for impairment each year in the fourth quarter and may be reviewed more frequently if certain events occur or circumstances change. The impairment review is performed by comparing each reporting unit's carrying value to its estimated fair value, determined through either estimated discounted future cash flows or market-based methodologies. If the carrying value exceeds the estimated fair value, we determine the fair value of all assets and liabilities of the reporting unit, including the implied fair value of goodwill. If the carrying value of goodwill exceeds the implied fair value, we recognize an impairment charge equal to the difference.

Intangible assets with indefinite lives are reviewed for impairment each year in the fourth quarter and may be reviewed more frequently if certain events occur or circumstances change. The impairment review is performed by comparing the carrying value to the estimated fair value, usually determined using a discounted cash flow methodology.

Factors used in the valuation of goodwill and intangible assets include, but are not limited to, management's plans for future operations, brand initiatives, recent operating results and projected future cash flows. If future economic conditions are different than those projected by management, future impairment charges may be required.

### ***Impairment of La Senza Goodwill and Indefinite Lived Intangible Assets***



In conjunction with the January 2007 acquisition of La Senza, we recorded \$313 million in goodwill and \$170 million in trade name intangible assets. These assets are included in the La Senza reporting unit which is part of the Victoria's Secret segment. In the fourth quarter of 2008, we completed our annual impairment testing under SFAS 142, *Goodwill and Other Intangible Assets* ("SFAS 142"). We concluded that goodwill and certain trade name assets related to the La Senza acquisition were impaired. We recorded impairment charges of \$189 million and \$26 million related to the goodwill and trade name assets, respectively. These impairment charges are included in Impairment of Goodwill and Other Intangible Assets on the 2008 Consolidated Statement of Income.

The estimated fair values of our other reporting units exceeded their respective carrying values as of the fourth quarter of 2008. Accordingly, no goodwill impairment charges were recorded for these reporting units. Reasonable changes in the significant estimates and assumptions used to determine these fair values would not have resulted in goodwill impairments in any of these reporting units. If economic conditions in 2009 and beyond continue to deteriorate, future impairment charges may be required.

#### *Impairment Indicators*

The primary impairment indicator associated with the impairment charge was the deterioration in La Senza's operating results during the latter half of 2008, particularly when compared to our expectations at the time of the acquisition. La Senza's operating results were negatively impacted by the global economic downturn and the resulting impact on the Canadian retail environment.

#### *Impairment Testing*

We evaluated La Senza's goodwill by comparing the carrying value of the La Senza reporting unit to the estimated fair value of the reporting unit derived using a discounted cash flow methodology. We corroborated the estimated fair value of the La Senza reporting unit as determined by our discounted cash flow approach by referencing a market-based methodology. Based on our evaluation, the carrying value of the La Senza reporting unit exceeded the estimated fair value. As a result, we measured the goodwill impairment in accordance with the provisions of SFAS 142 by comparing the carrying value of the reporting unit's goodwill to the implied value of the goodwill based on the estimated fair value of the reporting unit, considering the fair value of all assets and liabilities. As a result of this analysis, we recognized a goodwill impairment charge of \$189 million.

We evaluated the La Senza trade name assets by comparing the carrying value to the estimated fair value determined using a relief from royalty methodology. Based on our evaluation, the carrying value of certain La Senza trade name assets exceeded their estimated fair value and, as a result, we recognized impairment charges totaling \$26 million to reduce the carrying values to their estimated fair values.

#### *Significant Estimates and Assumptions*

The discounted cash flow models used to estimate the applicable fair values involve numerous estimates and assumptions that are highly subjective. Changes to these estimates and assumptions could materially impact the fair value estimates. The estimates and assumptions critical to the overall fair value estimates include: (i) estimated future cash flow generated by La Senza; (ii) discount rates used to derive the present value factors used in determining the fair values; and (iii) the terminal value assumption used in the discounted cash flow methodologies. These and other estimates and assumptions are impacted by economic conditions and expectations of management and may change in the future based on period-specific facts and circumstances. If economic conditions in 2009 and beyond continue to deteriorate, future impairment charges may be required.

#### *Sensitivity Analysis*

Our determination of the estimated fair value of the La Senza reporting unit and trade name assets requires significant judgment about economic factors, industry factors, as well as our views regarding the future prospects of the La Senza reporting unit. Changes in these judgments may have a significant effect on the estimated fair value of La Senza's goodwill and trade name assets. The following provides sensitivities related to the significant estimates and assumptions as noted above:

- a 10% decrease in estimated future cash flows would result in a \$33 million increase in the impairment charges.
- a 1% increase in the discount rate would result in a \$13 million increase in the impairment charges.
- a 10% decrease in the terminal value assumption would result in a \$25 million increase in the impairment charges.

## Claims and Contingencies

We are subject to various claims and contingencies related to lawsuits, insurance, regulatory and other matters arising out of the normal course of business. Our determination of the treatment of claims and contingencies in the Consolidated Financial Statements is based on management's view of the expected outcome of the applicable claim or contingency. We consult with legal counsel on matters related to litigation and seek input from both internal and external experts within and outside our organization with respect to matters in the ordinary course of business. We accrue a liability if the likelihood of an adverse outcome is probable and the amount is estimable. If the likelihood of an adverse outcome is only reasonably possible (as opposed to probable), or if an estimate is not determinable, disclosure of a material claim or contingency is disclosed in the Notes to the Consolidated Financial Statements included in Item 8. Financial Statements and Supplementary Data.

## Income Taxes

We account for income taxes under the asset and liability method. Under this method, the amount of taxes currently payable or refundable are accrued and deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets are also recognized for realizable operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted income tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in income tax rates is recognized in our Consolidated Statement of Income in the period that includes the enactment date. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets if it is more likely than not that such assets will not be realized.

Significant judgment is required in determining the provision for income taxes and related accruals, deferred tax assets and liabilities. In determining our provision for income taxes, we use an annual effective income tax rate based on annual income, permanent differences between book and tax income and statutory income tax rates. We adjust the annual effective income tax rate as additional information on outcomes or events becomes available. Our effective income tax rate is affected by items including changes in tax law, the tax jurisdiction of new stores or business ventures and the level of earnings.

Effective February 4, 2007, we adopted FASB Interpretation 48 ("FIN 48") and FASB Staff Position ("FSP") FIN 48-1, *Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement 109*. FIN 48 contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS 109, *Accounting for Income Taxes*. The first step is to evaluate the tax position for recognition by determining if the available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. We consider many factors when evaluating and estimating our tax positions and tax benefits, which may require periodic adjustments and which may not accurately forecast actual outcomes. Our policy is to include interest and penalties related to uncertain tax positions in income tax expense.

Our income tax returns, like those of most companies, are periodically audited by domestic and foreign tax authorities. These audits include questions regarding our tax filing positions, including the timing and amount of deductions and the allocation of income among various tax jurisdictions. At any one time, multiple tax years are subject to audit by the various tax authorities. We record an accrual for more likely than not exposures after evaluating the positions associated with our various income tax filings. A number of years may elapse before a particular matter for which we have established an accrual is audited and fully resolved or clarified. We adjust our tax contingencies accrual and income tax provision in the period in which matters are effectively settled with tax authorities at amounts different from our established accrual when the statute of limitations expires for the relevant taxing authority to examine the tax position or when more information becomes available.

Although we believe that our estimates are reasonable, actual results could differ from these estimates resulting in a final tax outcome that may be materially different from that which is reflected in our Consolidated Financial Statements.

## Revenue Recognition

While our recognition of revenue does not involve significant judgment, revenue recognition represents an important accounting policy for our organization. We recognize revenue upon customer receipt of the merchandise. For direct response revenues, we estimate shipments that have not been received by the customer based on shipping terms and historical delivery times. We also provide a reserve for projected merchandise returns based on prior experience.

All of our brands sell gift cards with no expiration dates to customers in retail stores, through our direct channels and through third parties. We do not charge administrative fees on unused gift cards. We recognize income from gift cards when they are redeemed by the customer. In addition, we recognize income on unredeemed gift cards when we can determine that the likelihood of the gift card being redeemed is remote and there is no legal obligation to remit the unredeemed gift cards to relevant jurisdictions (gift card breakage). We determine the gift card breakage rate based on historical redemption patterns. We accumulated sufficient historical

data to determine the gift card breakage rate at Bath & Body Works and Express during the fourth quarter of 2005 and Victoria's Secret during the fourth quarter of 2007. Gift card breakage is included in Net Sales in our Consolidated Statements of Income.

During the fourth quarter of 2005, we recognized \$30 million in pre-tax income related to the initial recognition of gift card breakage at Express and Bath & Body Works. During the fourth quarter of 2007, we recognized \$48 million in pre-tax income related to the initial recognition of gift card breakage at Victoria's Secret.

Additionally, we recognize revenue associated with merchandise sourcing services provided to third parties, consisting primarily of former subsidiaries as well as other third parties. Revenue is recognized at the time the title passes to the customer.

## Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995

We caution that any forward-looking statements (as such term is defined in the Private Securities Litigation Reform Act of 1995) contained in this report or made by our company or our management involve risks and uncertainties and are subject to change based on various important factors, many of which are beyond our control. Accordingly, our future performance and financial results may differ materially from those expressed or implied in any such forward-looking statements. Words such as “estimate,” “project,” “plan,” “believe,” “expect,” “anticipate,” “intend,” “planned,” “potential” and similar expressions may identify forward-looking statements. Risks associated with the following factors, among others, in some cases have affected and in the future could affect our financial performance and actual results and could cause actual results to differ materially from those expressed or implied in any forward-looking statements included in this report or otherwise made by our company or our management:

- general economic conditions, consumer confidence and consumer spending patterns;
- the global economic crisis and its impact on our suppliers, customers and other counterparties;
- the impact of the global economic crisis on our liquidity and capital resources;
- the dependence on a high volume of mall traffic and the possible lack of availability of suitable store locations on appropriate terms;
- the seasonality of our business;
- our ability to grow through new store openings and existing store remodels and expansions;
- our ability to expand into international markets;
- independent licensees;
- our direct channel business including our new distribution center;
- our failure to protect our reputation and our brand images;
- our failure to protect our trade names and trademarks;
- market disruptions including severe weather conditions, natural disasters, health hazards, terrorist activities or the prospect of these events;
- stock price volatility;
- our failure to maintain our credit rating;
- our ability to service our debt;
- the highly competitive nature of the retail industry generally and the segments in which we operate particularly;
- consumer acceptance of our products and our ability to keep up with fashion trends, develop new merchandise, launch new product lines successfully, offer products at the appropriate price points and enhance our brand image;
- our ability to retain key personnel;
- our ability to attract, develop and retain qualified employees and manage labor costs;
- our reliance on foreign sources of production, including risks related to:
  - political instability;
  - duties, taxes, other charges on imports;
  - legal and regulatory matters;
  - volatility in currency and exchange rates;
  - local business practices and political issues;
  - potential delays or disruptions in shipping and related pricing impacts; and
  - the disruption of imports by labor disputes;
- the possible inability of our manufacturers to deliver products in a timely manner or meet quality standards;
- fluctuations in energy costs;
- increases in the costs of mailing, paper and printing;
- self-insured risks;
- our ability to implement and sustain information technology systems;
- our failure to comply with regulatory requirements; and
- legal matters.

We are not under any obligation and do not intend to make publicly available any update or other revisions to any of the forward-looking statements contained in this report to reflect circumstances existing after the date of this report or to reflect the occurrence of future events even if experience or future events make it clear that any expected results expressed or implied by those forward-looking statements will not be realized.

LIMITED BRANDS, INC.  
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Our fiscal year ends on the Saturday closest to January 31. Fiscal years are designated in the Consolidated Financial Statements and Notes by the calendar year in which the fiscal year commences. The results for fiscal years 2008 and 2007 represent the 52 week period ending January 31, 2009 and February 2, 2008, respectively, and 2006 refers to the 53 week period ended February 3, 2007.

## Report of Independent Registered Public Accounting Firm on Consolidated Financial Statements

### To the Board of Directors and Shareholders of Limited Brands, Inc.:

We have audited the accompanying Consolidated Balance Sheets of Limited Brands, Inc. and subsidiaries as of January 31, 2009 and February 2, 2008, and the related Consolidated Statements of Income, Total Equity, and Cash Flows for each of the three years in the period ended January 31, 2009. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Limited Brands, Inc. and subsidiaries at January 31, 2009 and February 2, 2008, and the consolidated results of their operations and their cash flows for each of the three years in the period ended January 31, 2009, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 2 to the consolidated financial statements, the accompanying consolidated financial statements have been retrospectively adjusted for the adoption of Financial Accounting Standards Board ("FASB") Statement No. 160, "Noncontrolling Interests in Consolidated Financial Statements" (SFAS 160). Also as discussed in Note 2 to the consolidated financial statements, in 2007 the Company adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109", and in 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (R), "Share-Based Payment."

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Limited Brands, Inc. and subsidiaries' internal control over financial reporting as of January 31, 2009, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 27, 2009 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

March 27, 2009,  
except for the effects of the adoption of SFAS 160 and related disclosures in Notes 1, 2, and 10 as to which the date is June 12, 2009

**LIMITED BRANDS, INC.**  
**CONSOLIDATED STATEMENTS OF INCOME**  
(in millions except per share amounts)

|  | 2008           | 2007           | 2006           |
|--|----------------|----------------|----------------|
| Net Sales  | \$ 9,043       | \$10,134       | \$10,671       |
| Costs of Goods Sold, Buying and Occupancy  | (6,037)        | (6,625)        | (6,658)        |
| Gross Profit   | 3,006          | 3,509          | 4,013          |
| General, Administrative and Store Operating Expenses                               | (2,311)        | (2,616)        | (2,837)        |
| Impairment of Goodwill and Other Intangible Assets                                 | (215)          | (13)           | —              |
| Gain on Divestiture of Express   | —              | 302            | —              |
| Loss on Divestiture of Limited Stores  | —              | (72)           | —              |
| Net Gain on Joint Ventures   | 109            | —              | —              |
| Operating Income   | 589            | 1,110          | 1,176          |
| Interest Expense   | (181)          | (149)          | (102)          |
| Interest Income  | 18             | 18             | 25             |
| Other Income (Loss)  | 23             | 128            | (3)            |
| Income Before Income Taxes and Cumulative Effect of Change in Accounting Principle | 449            | 1,107          | 1,096          |
| Provision for Income Taxes   | 233            | 411            | 422            |
| Income Before Cumulative Effect of Change in Accounting Principle                  | 216            | 696            | 674            |
| Cumulative Effect of Change in Accounting Principle, Net of Taxes of \$0.4 in 2006 | —              | —              | 1              |
| Net Income   | 216            | 696            | 675            |
| Less: Net Income (Loss) Attributable to Noncontrolling Interest                    | (4)            | (22)           | (1)            |
| Net Income Attributable to Limited Brands, Inc.                                    | <u>\$ 220</u>  | <u>\$ 718</u>  | <u>\$ 676</u>  |
| <b>Net Income Attributable to Limited Brands, Inc. Per Basic Share</b>             |                |                |                |
| Income Before Cumulative Effect of Change in Accounting Principle                  | \$ 0.66        | \$ 1.91        | \$ 1.71        |
| Cumulative Effect of Change in Accounting Principle                                | —              | —              | —              |
| Net Income Attributable to Limited Brands, Inc. Per Basic Share                    | <u>\$ 0.66</u> | <u>\$ 1.91</u> | <u>\$ 1.71</u> |
| <b>Net Income Attributable to Limited Brands, Inc. Per Diluted Share</b>           |                |                |                |
| Income Before Cumulative Effect of Change in Accounting Principle                  | \$ 0.65        | \$ 1.89        | \$ 1.68        |
| Cumulative Effect of Change in Accounting Principle                                | —              | —              | —              |
| Net Income Attributable to Limited Brands, Inc. Per Diluted Share                  | <u>\$ 0.65</u> | <u>\$ 1.89</u> | <u>\$ 1.68</u> |

The accompanying Notes are an integral part of these Consolidated Financial Statements.

**LIMITED BRANDS, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
(in millions except per share amounts)

|   | January 31,<br>2009 | February 2,<br>2008 |
|---|---------------------|---------------------|
| <b>ASSETS</b>   |                     |                     |
| Current Assets:   |                     |                     |
| Cash and Cash Equivalents   | \$ 1,173            | \$ 1,018            |
| Accounts Receivable, Net  | 236                 | 355                 |
| Inventories   | 1,182               | 1,251               |
| Other   | 276                 | 295                 |
| Total Current Assets  | 2,867               | 2,919               |
| Property and Equipment, Net   | 1,929               | 1,862               |
| Goodwill  | 1,426               | 1,733               |
| Trade Names and Other Intangible Assets, Net  | 580                 | 677                 |
| Other Assets  | 170                 | 246                 |
| Total Assets  | <u>\$ 6,972</u>     | <u>\$ 7,437</u>     |
| <b>LIABILITIES AND EQUITY</b>   |                     |                     |
| Current Liabilities:  |                     |                     |
| Accounts Payable  | \$ 494              | \$ 517              |
| Accrued Expenses and Other  | 669                 | 721                 |
| Income Taxes  | 92                  | 136                 |
| Total Current Liabilities   | 1,255               | 1,374               |
| Deferred Income Taxes   | 213                 | 175                 |
| Long-term Debt  | 2,897               | 2,905               |
| Other Long-term Liabilities   | 732                 | 709                 |
| Shareholders' Equity:   |                     |                     |
| Preferred Stock - \$1.00 par value; 10 shares authorized; none issued   | —                   | —                   |
| Common Stock - \$0.50 par value; 1,000 shares authorized; 524 shares issued in 2008 and 2007; 321 and 346 shares outstanding in 2008 and 2007 | 262                 | 262                 |
| Paid-in Capital   | 1,544               | 1,550               |
| Accumulated Other Comprehensive (Loss) Income   | (28)                | 31                  |
| Retained Earnings   | 4,777               | 4,758               |
| Less: Treasury Stock, at Average Cost; 203 shares in 2008 and 178 shares in 2007  | (4,681)             | (4,382)             |
| Total Limited Brands, Inc. Shareholders' Equity   | 1,874               | 2,219               |
| Noncontrolling Interest   | 1                   | 55                  |
| Total Equity  | 1,875               | 2,274               |
| Total Liabilities and Equity  | <u>\$ 6,972</u>     | <u>\$ 7,437</u>     |

The accompanying Notes are an integral part of these Consolidated Financial Statements.



**LIMITED BRANDS, INC.**  
**CONSOLIDATED STATEMENTS OF TOTAL EQUITY**  
(in millions except per share amounts)

|   | Common Stock       |               | Paid-In Capital | Accumulated Other Comprehensive Income (Loss) | Retained Earnings | Treasury Stock, at Average Cost | Noncontrolling Interest | Total Equity    |
|---|--------------------|---------------|-----------------|---|-------------------|---------------------------------|-------------------------|-----------------|
|   | Shares Outstanding | Par Value     |                 |   |                   |                                 |                         |                 |
| <b>Balance, January 28, 2006</b>  | <u>395</u>         | <u>\$ 262</u> | <u>\$1,597</u>  | <u>\$ (6)</u>                                 | <u>\$ 3,839</u>   | <u>\$ (3,221)</u>               | <u>\$ 33</u>            | <u>\$ 2,504</u> |
| Capital Contributions from Noncontrolling Interest and Other  | —                  | —             | —               | —   | —                 | —                               | 39                      | 39              |
| Comprehensive Income (Loss):  |                    |               |                 |   |                   |                                 |                         |                 |
| Net Income (Loss)   | —                  | —             | —               | —   | 676               | —                               | (1)                     | 675             |
| Foreign Currency Translation  | —                  | —             | —               | (7)   | —                 | —                               | —                       | (7)             |
| Unrealized Loss on Cross Currency Interest Rate Cash Flow Hedge   | —                  | —             | —               | (3)   | —                 | —                               | —                       | (3)             |
| Reclassification of Cash Flow Hedges to Earnings  | —                  | —             | —               | (3)   | —                 | —                               | —                       | (3)             |
| Realized Loss on Cash Flow Hedge  | —                  | —             | —               | 2   | —                 | —                               | —                       | 2               |
| Total Comprehensive Income (Loss)   | —                  | —             | —               | (11)  | 676               | —                               | (1)                     | 664             |
| Cash Dividends (\$0.60 per share)   | —                  | —             | —               | —   | (238)             | —                               | —                       | (238)           |
| Repurchase of Common Stock  | (7)                | —             | —               | —   | —                 | (183)                           | —                       | (183)           |
| Exercise of Stock Options and Other   | 10                 | —             | (32)            | —   | —                 | 272                             | —                       | 240             |
| <b>Balance, February 3, 2007</b>  | <u>398</u>         | <u>\$ 262</u> | <u>\$1,565</u>  | <u>\$ (17)</u>                                | <u>\$ 4,277</u>   | <u>\$ (3,132)</u>               | <u>\$ 71</u>            | <u>\$ 3,026</u> |
| Capital Contributions from Noncontrolling Interest and Other  | —                  | —             | —               | —   | —                 | —                               | 6                       | 6               |
| Adoption of Financial Accounting Standards Board Interpretation 48, <i>Accounting for Uncertainty in Income Taxes</i> | —                  | —             | —               | —   | (10)              | —                               | —                       | (10)            |
| Comprehensive Income (Loss):  |                    |               |                 |   |                   |                                 |                         |                 |
| Net Income (Loss)   | —                  | —             | —               | —   | 718               | —                               | (22)                    | 696             |
| Foreign Currency Translation  | —                  | —             | —               | 37  | —                 | —                               | —                       | 37              |
| Unrealized Loss on Cross Currency Interest Rate Cash Flow Hedge   | —                  | —             | —               | (51)  | —                 | —                               | —                       | (51)            |
| Reclassification of Cash Flow Hedges to Earnings  | —                  | —             | —               | 75  | —                 | —                               | —                       | 75              |
| Unrealized Loss on Interest Rate Cash Flow Hedge  | —                  | —             | —               | (13)  | —                 | —                               | —                       | (13)            |
| Total Comprehensive Income (Loss)   | —                  | —             | —               | 48  | 718               | —                               | (22)                    | 744             |
| Cash Dividends (\$0.60 per share)   | —                  | —             | —               | —   | (227)             | —                               | —                       | (227)           |
| Repurchase of Common Stock  | (59)               | —             | —               | —   | —                 | (1,410)                         | —                       | (1,410)         |
| Exercise of Stock Options and Other   | 7                  | —             | (15)            | —   | —                 | 160                             | —                       | 145             |
| <b>Balance, February 2, 2008</b>  | <u>346</u>         | <u>\$ 262</u> | <u>\$1,550</u>  | <u>\$ 31</u>                                  | <u>\$ 4,758</u>   | <u>\$ (4,382)</u>               | <u>\$ 55</u>            | <u>\$ 2,274</u> |
| Capital Contributions from Noncontrolling Interest and Other  | —                  | —             | —               | —   | —                 | —                               | 4                       | 4               |
| Divestiture of Personal Care Business   | —                  | —             | —               | —   | —                 | —                               | (54)                    | (54)            |
| Comprehensive Income (Loss):  |                    |               |                 |   |                   |                                 |                         |                 |
| Net Income (Loss)   | —                  | —             | —               | —   | 220               | —                               | (4)                     | 216             |
| Foreign Currency Translation  | —                  | —             | —               | (34)  | —                 | —                               | —                       | (34)            |
| Unrealized Gain on Cross Currency Interest Rate Cash Flow Hedge   | —                  | —             | —               | 81  | —                 | —                               | —                       | 81              |
| Reclassification of Cash Flow Hedges to Earnings  | —                  | —             | —               | (91)  | —                 | —                               | —                       | (91)            |
| Unrealized Loss on Interest Rate Cash Flow Hedge  | —                  | —             | —               | (16)  | —                 | —                               | —                       | (16)            |
| Realized Loss on Cash Flow Hedge  | —                  | —             | —               | 1   | —                 | —                               | —                       | 1               |
| Total Comprehensive Income (Loss)   | —                  | —             | —               | (59)  | 220               | —                               | (4)                     | 157             |
| Cash Dividends (\$0.60 per share)   | —                  | —             | —               | —   | (201)             | —                               | —                       | (201)           |
| Repurchase of Common Stock  | (28)               | —             | —               | —   | —                 | (371)                           | —                       | (371)           |
| Exercise of Stock Options and Other   | 3                  | —             | (6)             | —   | —                 | 72                              | —                       | 66              |
| <b>Balance, January 31, 2009</b>  | <u>321</u>         | <u>\$ 262</u> | <u>\$1,544</u>  | <u>\$ (28)</u>                                | <u>\$ 4,777</u>   | <u>\$ (4,681)</u>               | <u>\$ 1</u>             | <u>\$ 1,875</u> |

The accompanying Notes are an integral part of these Consolidated Financial Statements.

**LIMITED BRANDS, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in millions)

|  | <u>2008</u>    | <u>2007</u>     | <u>2006</u>    |
|--|----------------|-----------------|----------------|
| <b>Operating Activities</b>  |                |                 |                |
| Net Income   | \$ 216         | \$ 696          | \$ 675         |
| Adjustments to Reconcile Net Income to Net Cash Provided by (Used for) Operating Activities: |                |                 |                |
| Cumulative Effect of Change in Accounting Principle  | —              | —               | (1)            |
| Depreciation and Amortization  | 343            | 352             | 316            |
| Goodwill and Intangible Asset Impairment Charges   | 215            | 13              | —              |
| Deferred Income Taxes  | 46             | (5)             | (43)           |
| Excess Tax Benefits From Share-based Compensation  | (2)            | (28)            | (46)           |
| Share-based Compensation Expense   | 35             | 44              | 37             |
| Net Gain on Joint Ventures   | (109)          | —               | —              |
| Gain on Distribution from Express  | (13)           | —               | —              |
| Gain on Divestiture of Express   | —              | (302)           | —              |
| Loss on Divestiture of Limited Stores  | —              | 72              | —              |
| Gain on Distribution from Easton Town Center, LLC  | —              | (100)           | —              |
| Gains on Sales of Assets   | —              | (37)            | (16)           |
| Changes in Assets and Liabilities, Net of Assets and Liabilities from Acquisitions:          |                |                 |                |
| Accounts Receivable  | 103            | (192)           | 18             |
| Inventories  | 45             | 337             | (545)          |
| Accounts Payable, Accrued Expenses and Other   | (39)           | (152)           | 115            |
| Income Taxes Payable   | (39)           | (31)            | 16             |
| Other Assets and Liabilities   | 153            | 98              | 74             |
| Net Cash Provided by Operating Activities  | <u>954</u>     | <u>765</u>      | <u>600</u>     |
| <b>Investing Activities</b>  |                |                 |                |
| Capital Expenditures   | (479)          | (749)           | (548)          |
| Net Proceeds from the Divestiture of Joint Venture   | 159            | —               | —              |
| Return of Capital from Express   | 95             | —               | —              |
| Proceeds from the Divestiture of Express, Net  | —              | 547             | —              |
| Proceeds from the Distribution from Easton Town Center, LLC                                  | —              | 102             | —              |
| Proceeds from Sale of Assets   | —              | 97              | 27             |
| Acquisition of La Senza Corporation, Net of Cash Acquired of \$28                            | —              | —               | (572)          |
| Other Investing Activities   | (15)           | 33              | —              |
| Net Cash (Used for) Provided by Investing Activities   | <u>(240)</u>   | <u>30</u>       | <u>(1,093)</u> |
| <b>Financing Activities</b>  |                |                 |                |
| Proceeds from Issuance of Debt   | —              | 997             | —              |
| Proceeds from Term Loan Refinancing  | —              | 250             | —              |
| Repayment of Long-term Debt  | (15)           | (7)             | (7)            |
| Repurchase of Common Stock   | (379)          | (1,402)         | (193)          |
| Dividends Paid   | (201)          | (227)           | (238)          |
| Excess Tax Benefits from Share-based Compensation  | 2              | 28              | 46             |
| Proceeds From Exercise of Stock Options and Other  | 31             | 82              | 177            |
| Net Cash Used for Financing Activities   | <u>(562)</u>   | <u>(279)</u>    | <u>(215)</u>   |
| Effects of Exchange Rate Changes on Cash   | 3              | 2               | —              |
| Net Increase (Decrease) in Cash and Cash Equivalents   | 155            | 518             | (708)          |
| Cash and Cash Equivalents, Beginning of Year   | 1,018          | 500             | 1,208          |
| Cash and Cash Equivalents, End of Year   | <u>\$1,173</u> | <u>\$ 1,018</u> | <u>\$ 500</u>  |

The accompanying Notes are an integral part of these Consolidated Financial Statements.

**LIMITED BRANDS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Description of Business and Summary of Significant Accounting Policies**

**Description of Business**

Limited Brands, Inc. (the Company) operates in the highly competitive specialty retail business. The Company is a specialty retailer of women's intimate and other apparel, beauty and personal care products and accessories. The Company sells its merchandise through specialty retail stores in the United States and Canada, which are primarily mall-based, and through its websites and catalogue. The Company currently operates the following retail brands:

- Victoria's Secret
- Pink (Victoria's Secret)
- La Senza
- Bath & Body Works
- C. O. Bigelow
- The White Barn Candle Company
- Henri Bendel

**Basis of Consolidation**

The Consolidated Financial Statements include the accounts of the Company and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. The Consolidated Financial Statements include the results of Express and Limited Stores through their divestiture dates which were July 6, 2007 and August 3, 2007, respectively.

Subsequent to the divestitures of Express and Limited Stores, the Company's remaining 25% ownership interest in each is accounted for under the equity method of accounting. The Company eliminates in consolidation 25% of sourcing sales to Express and Limited Stores consistent with the Company's ownership percentage.

The Company's Consolidated Financial Statements also include less than 100% owned variable interest entities in which the Company is designated as the primary beneficiary in accordance with Financial Accounting Standards Board Interpretation 46(R), *Consolidation of Variable Interest Entities*, ("FIN 46(R)").

The Company accounts for investments in unconsolidated entities where it exercises significant influence, but does not have control, using the equity method of accounting. Under the equity method of accounting, the Company recognizes its share of the investee net income or loss. Losses are only recognized to the extent the Company has positive carrying value related to the investee. Carrying values are only reduced below zero if the Company has an obligation to provide funding to the investee. The Company's share of net income or loss of unconsolidated entities from which the Company purchases merchandise or merchandise components is included in Cost of Goods Sold, Buying and Occupancy on the Consolidated Statements of Income. The Company's share of net income or loss of all other unconsolidated entities is included in Other Income (Loss) on the Consolidated Statements of Income. The Company's equity investments are required to be tested for impairment when it is determined there may be an other than temporary loss in value.

**Fiscal Year**

The Company's fiscal year ends on the Saturday nearest to January 31. As used herein, "2008" and "2007" refer to the 52-week periods ending January 31, 2009 and February 2, 2008, respectively. "2006" refers to the 53-week period ended February 3, 2007.

**Cash and Cash Equivalents**

Cash and Cash Equivalents include cash on hand, demand deposits with financial institutions and highly liquid investments with original maturities of less than 90 days. The Company's outstanding checks, which amounted to \$86 million as of January 31, 2009 and \$121 million as of February 2, 2008, are included in Accounts Payable on the Consolidated Balance Sheets.

**Concentration of Credit Risk**

The Company maintains cash and cash equivalents with various major financial institutions, as well as corporate commercial paper from time to time. Currently, the Company's investment portfolio is comprised primarily of U.S. government-backed securities.

The Company monitors the relative credit standing of financial institutions and other entities with whom the Company transacts and limits the amount of credit exposure with any one entity. The Company also monitors the creditworthiness of entities to which the Company grants credit terms in the normal course of business and counterparties to derivative instruments.

### **Inventories**

Inventories are principally valued at the lower of cost or market, on a weighted-average cost basis.

The Company records valuation adjustments to its inventories if the cost of specific inventory items on hand exceeds the amount it expects to realize from the ultimate sale or disposal of the inventory. These estimates are based on management's judgment regarding future demand and market conditions and analysis of historical experience.

The Company also records inventory loss adjustments for estimated physical inventory losses that have occurred since the date of the last physical inventory. These estimates are based on management's analysis of historical results and operating trends.

### **Catalogue and Advertising Costs**

The Company capitalizes the direct costs of producing and distributing its catalogues and amortizes the costs over the expected future revenue stream, which is generally three months from the date the catalogues are mailed.

The Company's capitalized direct response advertising costs amounted to \$27 million and \$33 million as of January 31, 2009 and February 2, 2008, respectively, and are included in Other Current Assets on the Consolidated Balance Sheets. All other advertising costs are expensed at the time the promotion first appears in media or in the store. Catalogue and advertising costs amounted to \$502 million for 2008, \$507 million for 2007 and \$594 million for 2006.

### **Property and Equipment**

The Company's property and equipment are recorded at cost and depreciation/amortization is computed on a straight-line basis using the following depreciable life ranges:

| <u>Category of Property and Equipment</u>               | <u>Depreciable Life Range</u>     |
|---|-----------------------------------|
| Software, including software developed for internal use | 3 - 7 years                       |
| Store related assets                                    | 3 - 10 years                      |
| Leasehold improvements                                  | Shorter of lease term or 10 years |
| Non-store related building and site improvements        | 10 - 15 years                     |
| Other property and equipment                            | 20 years                          |
| Buildings   | 30 years                          |

When a decision has been made to dispose of property and equipment prior to the end of the previously estimated useful life, depreciation estimates are revised to reflect the use of the asset over the shortened estimated useful life. The Company's cost of assets sold or retired and the related accumulated depreciation are removed from the accounts with any resulting gain or loss included in net income. Maintenance and repairs are charged to expense as incurred. Major renewals and betterments that extend useful lives are capitalized.

Property and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. If the estimated undiscounted future cash flows related to the asset are less than the carrying value, the Company recognizes a loss equal to the difference between the carrying value and the estimated fair value, usually determined by the estimated discounted future cash flows of the asset. Factors used in the valuation include, but are not limited to, management's plans for future operations, brand initiatives, recent operating results and projected future cash flows.

### **Goodwill and Intangible Assets**

The Company has certain intangible assets resulting from business combinations that are recorded at cost. Intangible assets with finite lives are amortized primarily on a straight-line basis over their respective estimated useful lives ranging from 3 to 20 years.

Intangible assets with finite lives are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. If the estimated undiscounted future cash flows related to the asset are less than the carrying value, the Company recognizes a loss equal to the difference between the carrying value and the estimated fair value, usually determined by the estimated discounted future cash flows of the asset. Factors used in the valuation include, but are not limited to, management's plans for future operations, brand initiatives, recent operating results and projected future cash flows.

Goodwill represents the excess of the purchase price over the fair value of the net assets acquired. Goodwill is not subject to periodic amortization. Goodwill is reviewed for impairment each year in the fourth quarter and may be reviewed more frequently if certain events occur or circumstances change. The impairment review is performed by comparing each reporting unit's carrying

value to its estimated fair value, determined through either estimated discounted future cash flows or market-based methodologies. If the carrying value exceeds the estimated fair value, the Company determines the fair value of all assets and liabilities of the reporting unit, including the implied fair value of goodwill. If the carrying value of goodwill exceeds the implied fair value, the Company recognizes an impairment charge equal to the difference.

Intangible assets with indefinite lives are reviewed for impairment each year in the fourth quarter and may be reviewed more frequently if certain events occur or circumstances change. The impairment review is performed by comparing the carrying value to the estimated fair value, usually determined using a discounted cash flow methodology.

Factors used in the valuation of goodwill and intangible assets include, but are not limited to, management's plans for future operations, brand initiatives, recent operating results and projected future cash flows. If future economic conditions are different than those projected by management, future impairment charges may be required.

### **Leases and Leasehold Improvements**

The Company has leases that contain predetermined fixed escalations of minimum rentals and/or rent abatements subsequent to taking possession of the leased property. The Company recognizes the related rent expense on a straight-line basis commencing upon store possession date. The Company records the difference between the recognized rental expense and amounts payable under the leases as deferred lease credits. The Company's liability for predetermined fixed escalations of minimum rentals and/or rent abatements amounted to \$90 million as of January 31, 2009 and \$77 million as of February 2, 2008. These liabilities are included in Other Long-term Liabilities on the Consolidated Balance Sheets.

The Company receives allowances from landlords related to its retail stores. These allowances are generally comprised of cash amounts received by the Company from its landlords as part of the negotiated lease terms. The Company records a receivable and a landlord allowance at the lease commencement date (date of initial possession of the store). The deferred lease credit is amortized on a straight-line basis as a reduction of rent expense over the term of the lease (including the pre-opening build-out period) and the receivable is reduced as amounts are received from the landlord. The Company's unamortized portion of landlord allowances, which amounted to \$224 million as of January 31, 2009 and \$185 million as of February 2, 2008, is included in Other Long-term Liabilities on the Consolidated Balance Sheets.

The Company also has leasehold improvements which are amortized over the shorter of their estimated useful lives or the period from the date the assets are placed in service to the end of the initial lease term. Leasehold improvements made after the inception of the initial lease term are depreciated over the shorter of their estimated useful lives or the remaining lease term, including renewal periods, if reasonably assured.

### **Foreign Currency Translation**

The functional currency of the Company's foreign operations is generally the applicable local currency. Assets and liabilities are translated into U.S. dollars using the current exchange rates in effect as of the balance sheet date, while revenues and expenses are translated at the average exchange rates for the period. The Company's resulting translation adjustments are recorded as a component of Accumulated Other Comprehensive Income (Loss) within the Consolidated Statements of Shareholders' Equity.

### **Derivative Financial Instruments**

The Company uses derivative financial instruments to manage exposure to foreign currency exchange rates and interest rates. The Company does not use derivative financial instruments for trading purposes. Derivative financial instruments are accounted for in accordance with SFAS 133, *Accounting for Derivative Instruments and Hedging Activities* ("SFAS 133") as amended, which requires that all derivative instruments be recorded on the Consolidated Balance Sheets at fair value.

### **Income Taxes**

The Company accounts for income taxes under the asset and liability method. Under this method, the amount of taxes currently payable or refundable are accrued and deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets are also recognized for realizable operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted income tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in income tax rates is recognized in the Company's Consolidated Statement of Income in the period that includes the enactment date. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets if it is more likely than not that such assets will not be realized.

In determining the Company's provision for income taxes, it uses an annual effective income tax rate based on annual income, permanent differences between book and tax income and statutory income tax rates. The Company adjusts the annual effective

income tax rate as additional information on outcomes or events becomes available. The Company's effective income tax rate is affected by items including changes in tax law, the tax jurisdiction of new stores or business ventures and the level of earnings.

Effective February 4, 2007, the Company adopted Financial Accounting Standards Board ("FASB") Interpretation 48 ("FIN 48") and FASB Staff Position ("FSP") FIN 48-1, *Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement 109*. FIN 48 contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS 109, *Accounting for Income Taxes*. The first step is to evaluate the tax position for recognition by determining if the available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. The Company considers many factors when evaluating and estimating its tax positions and tax benefits, which may require periodic adjustments and which may not accurately forecast actual outcomes.

The Company's income tax returns, like those of most companies, are periodically audited by domestic and foreign tax authorities. These audits include questions regarding the Company's tax filing positions, including the timing and amount of deductions and the allocation of income among various tax jurisdictions. At any one time, multiple tax years are subject to audit by the various tax authorities. The Company records an accrual for more likely than not exposures after evaluating the positions associated with its various income tax filings. A number of years may elapse before a particular matter for which the Company has established an accrual is audited and fully resolved or clarified. The Company adjusts its tax contingencies accrual and income tax provision in the period in which matters are effectively settled with tax authorities at amounts different from its established accrual, when the statute of limitations expires for the relevant taxing authority to examine the tax position or when more information becomes available. The Company includes its tax contingencies accrual, including accrued penalties and interest, in Other Long-term Liabilities on the Consolidated Balance Sheets unless the liability is expected to be paid within one year. Changes to the tax contingencies accrual, including accrued penalties and interest, are included in Provision for Income Taxes on the Consolidated Statements of Income.

### **Self Insurance**

The Company is self-insured for medical, workers' compensation, property, general liability and automobile liability up to certain stop-loss limits. Such costs are accrued based on known claims and an estimate of incurred but not reported ("IBNR") claims. IBNR claims are estimated using historical claim information and actuarial estimates.

### **Noncontrolling Interest**

Noncontrolling interest represents the portion of equity interests of consolidated affiliates not owned by the Company.

### **Share-based Compensation**

The Company accounts for share-based employee compensation in accordance with SFAS 123 (revised 2004), *Share-Based Payment* ("SFAS 123(R)"). SFAS 123(R) requires all share-based payments to employees and directors to be recognized in the financial statements as compensation cost over the service period based on their estimated fair value on the date of grant.

Compensation cost is recognized over the service period on a straight-line basis for the fair value of awards that actually vest. Compensation expense for stock options is recognized, net of forfeitures, using a single option approach (each option is valued as one grant, irrespective of the number of vesting tranches). Compensation cost for restricted stock is recognized, net of forfeitures, on a straight-line basis over the requisite service period.

The Company has a policy of issuing treasury shares to satisfy award exercises or conversions.

### **Revenue Recognition**

The Company recognizes sales upon customer receipt of the merchandise, which for direct response revenues reflects an estimate of shipments that have not yet been received by the customer based on shipping terms and estimated delivery times. The Company's shipping and handling revenues are included in Net Sales with the related costs included in Costs of Goods Sold, Buying and Occupancy on the Consolidated Statements of Income. The Company also provides a reserve for projected merchandise returns based on prior experience. Net Sales exclude sales tax collected from customers.

The Company's brands sell gift cards with no expiration dates to customers. The Company does not charge administrative fees on unused gift cards. The Company recognizes income from gift cards when they are redeemed by the customer. In addition, the Company recognizes income on unredeemed gift cards when it can determine that the likelihood of the gift card being redeemed is remote and that there is no legal obligation to remit the unredeemed gift cards to relevant jurisdictions (gift card breakage). The Company determines the gift card breakage rate based on historical redemption patterns. The Company accumulated enough historical data to determine the gift card breakage rate at Bath & Body Works during the fourth quarter of 2005 and Victoria's Secret during the fourth quarter of 2007. Gift card breakage is included in Net Sales in the Consolidated Statements of Income.

During the fourth quarter of 2007, the Company recognized \$48 million in pre-tax income related to the initial recognition of gift card breakage at Victoria's Secret.

Additionally, the Company recognizes revenue associated with merchandise sourcing services provided to third parties, consisting of former subsidiaries as well as other third parties. Revenue is recognized at the time the title passes to the customer.

### **Costs of Goods Sold, Buying and Occupancy**

The Company's costs of goods sold include merchandise costs, net of discounts and allowances, freight and inventory shrinkage. The Company's buying and occupancy expenses primarily include payroll, benefit costs and operating expenses for its buying departments and distribution network, rent, common area maintenance, real estate taxes, utilities, maintenance, catalogue amortization and depreciation for the Company's stores, warehouse facilities and equipment.

### **General, Administrative and Store Operating Expenses**

The Company's general, administrative and store operating expenses primarily include payroll and benefit costs for its store-selling and administrative departments (including corporate functions), marketing, advertising and other operating expenses not specifically categorized elsewhere in the Consolidated Statements of Income.

### **Use of Estimates in the Preparation of Financial Statements**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period, as well as the related disclosure of contingent assets and liabilities at the date of the financial statements. Actual results may differ from those estimates and the Company revises its estimates and assumptions as new information becomes available.

### **Reclassifications**

Certain prior period amounts have been reclassified to conform to the current period presentation.

## **2. New Accounting Pronouncements and Changes in Accounting Principle**

### ***New Accounting Pronouncements***

#### ***SFAS 161, Disclosures about Derivative Instruments and Hedging Activities ("SFAS 161")***

In March 2008, the FASB issued SFAS 161, which requires disclosures about the fair value of derivative instruments and their gains or losses in tabular format as well as disclosures regarding credit-risk-related contingent features in derivative agreements, counterparty credit risk and strategies and objectives for using derivative instruments. SFAS 161 amends and expands SFAS 133 and is effective prospectively beginning in 2009. Adoption of SFAS 161 will impact the Company's disclosures about derivative instruments and hedging activities beginning in 2009.

#### ***SFAS 141 (revised 2007), Business Combinations ("SFAS 141(R)")***

In December 2007, the FASB issued SFAS 141(R), which establishes how the acquiring entity recognizes and measures the assets acquired, liabilities assumed, any gain on bargain purchases and any noncontrolling interest in the acquired entity. SFAS 141(R) requires acquisition-related costs to be expensed in the periods they are incurred, with the exception of the costs to issue debt or equity securities. SFAS 141(R) requires disclosure of information for a business combination that occurs during the accounting period or prior to the issuance of the financial statements for the accounting period. SFAS 141(R) is effective prospectively for business combinations with an acquisition date on or after the beginning of the first annual reporting period after December 15, 2008. Adoption of SFAS 141(R) is not expected to have an impact to the Company's financial statements.

### *SFAS 160, Noncontrolling Interests in Consolidated Financial Statements (“SFAS 160”)*

In December 2007, the FASB issued SFAS 160, which modifies reporting for noncontrolling interest (minority interest) in consolidated financial statements. SFAS 160 requires noncontrolling interest be reported in equity and establishes a new framework for recognizing net income or loss and comprehensive income by the controlling interest. SFAS 160 requires specific disclosures regarding changes in equity interest of both the controlling and noncontrolling parties and presentation of the noncontrolling equity balance and income or loss for all periods presented. SFAS 160 is effective for interim and annual periods in fiscal years beginning after December 15, 2008.

Upon adoption, prior period financial statements were recast for the presentation of the noncontrolling interest consistent with the retrospective application required by SFAS 160. The impact of the retrospective application of this standard is as follows:

- Reclassifies Minority Interest to Net Income (Loss) Attributable to Noncontrolling Interest on the Consolidated Statements of Income;
- Reclassifies Minority Interest to Noncontrolling Interest within the Total Equity section on the Consolidated Balance Sheets;
- Includes changes in Noncontrolling Interests on the Consolidated Statements of Total Equity; and
- Reclassifies Minority Interest to Net Income on the Consolidated Statements of Cash Flow.

In addition, the Company adjusted references to these items in the notes to the Company’s consolidated financial statements.

### *SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities (“SFAS 159”)*

In February 2007, the FASB issued SFAS 159 permitting entities to choose to measure many financial instruments and certain other items at fair value. The standard also establishes presentation and disclosure requirements designed to facilitate comparison between entities that choose different measurement attributes for similar types of assets and liabilities. If the fair value option is elected, the effect of the first remeasurement to fair value is reported as a cumulative effect adjustment to the opening balance of retained earnings. The statement is applied prospectively upon adoption. The Company did not adopt fair value treatment for any assets or liabilities under SFAS 159 as of the beginning of 2008.

### *SFAS 157, Fair Value Measurements (“SFAS 157”)*

In September 2006, the FASB issued SFAS 157, which provides guidance for fair value measurement of assets and liabilities and instruments measured at fair value that are classified in shareholders’ equity. The statement defines fair value, establishes a fair value measurement framework and expands fair value disclosures. It emphasizes that fair value is market-based with the highest measurement hierarchy level being market prices in active markets. The standard requires fair value measurements be disclosed by hierarchy level, an entity include its own credit standing in the measurement of its liabilities and modifies the transaction price presumption.

In February 2008, the FASB issued FSP FAS 157-2, *Effective Date of FASB Statement 157*, which delays the effective date of SFAS 157 to fiscal years beginning after November 15, 2008 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually).

Accordingly, as of February 3, 2008, the Company adopted SFAS 157 for financial assets and liabilities only. As of January 31, 2009, the Company’s financial assets and liabilities subject to SFAS 157 consisted of the cross-currency interest rate swaps and the participating interest rate swap. The fair value of these instruments is determined using valuation methodologies that employ Level 2 inputs as defined in SFAS 157. The adoption of SFAS 157 for financial assets and financial liabilities did not have a significant impact on the Company’s results of operations, financial condition or liquidity. Adoption of portions of SFAS 157 within the scope of FSP FAS 157-2 is not expected to have a material impact on the Company’s financial statements beginning in 2009.

## **Changes in Accounting Principle**

### *Income Taxes*

Effective February 4, 2007, the Company adopted FIN 48, *Accounting for Uncertainty in Income Taxes* (“FIN 48”), an interpretation of FASB Statement 109. Upon adoption, the Company recognized an additional \$10 million liability for unrecognized tax benefits, which was accounted for as a reduction to the Company’s opening balance of retained earnings on February 4, 2007. For additional information, see Note 13, “Income Taxes.”

### *Share-based Compensation*



On January 29, 2006, the Company adopted SFAS 123 (revised 2004), *Share-Based Payment* (“SFAS 123(R)”), which requires the measurement and recognition of compensation expense for all share-based awards made to employees and directors based on estimated fair values on the grant date. Prior to the adoption of SFAS 123(R), the Company accounted for share-based awards to employees and directors using the intrinsic value method in accordance with Accounting Principles Board Opinion 25, *Accounting for Stock Issued to Employees* (“APB 25”). Under the intrinsic value method, no stock-based compensation expense was recognized in the Company’s Consolidated Statements of Income, other than for restricted stock, because the exercise price of the Company’s stock options granted to employees and directors was equal to the estimated fair market value of the underlying stock at the date of grant.

The Company adopted SFAS 123(R) using the modified prospective transition method, which required the application of the accounting standard as of January 29, 2006, the first day of the Company’s fiscal year 2006.

Share-based compensation expense recognized in the Consolidated Statements of Income under SFAS 123(R) is based on awards ultimately expected to vest and, accordingly, has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The cumulative effect of change in accounting principle on the Consolidated Statement of Income for the year ended February 3, 2007 of \$0.7 million (net of tax of \$0.4 million) relates to an estimate of forfeitures of previously recognized unvested restricted stock awards outstanding as of January 29, 2006, the date of adoption of SFAS 123(R).

### 3. Earnings Per Share

Earnings per basic share is computed based on the weighted-average number of outstanding common shares. Earnings per diluted share include the weighted-average effect of dilutive options and restricted stock on the weighted-average shares outstanding.

The following table provides shares utilized for the calculation of basic and diluted earnings per share for 2008, 2007 and 2006:

|   | <u>2008</u>   | <u>2007</u> | <u>2006</u> |
|---|---------------|-------------|-------------|
|   | (in millions) |             |             |
| Common Shares Issued                            | 524           | 524         | 524         |
| Treasury Shares                                 | (189)         | (149)       | (128)       |
| <b>Basic Shares</b>                             | <u>335</u>    | <u>375</u>  | <u>396</u>  |
| Effect of Dilutive Options and Restricted Stock | 2             | 5           | 7           |
| <b>Diluted Shares</b>                           | <u>337</u>    | <u>380</u>  | <u>403</u>  |
| Anti-dilutive Options (a)                       | 15            | 9           | 6           |

(a) These options were excluded from the calculation of diluted earnings per share because the exercise prices were greater than or equal to the average market price of the common shares and, therefore, their inclusion would have been anti-dilutive.

### 4. Derivative Financial Instruments

The Company has foreign exchange rate exposure primarily as a result of the January 2007 acquisition of La Senza Corporation whose operations are conducted primarily in Canada. To mitigate the exposure to fluctuations in the U.S. dollar-Canadian dollar exchange rate, the Company entered into a series of cross-currency swaps related to approximately \$470 million Canadian dollar denominated intercompany loans. These cross-currency swaps require the periodic exchange of fixed rate Canadian dollar interest payments for fixed rate U.S. dollar interest payments as well as exchange of Canadian dollar and U.S. dollar principal payments upon maturity. The swap arrangements mature between 2015 and 2018 at the same time as the related loans.

The cross-currency interest rate swaps are designated as cash flow hedges of foreign currency exchange risk. Changes in the U.S. dollar-Canadian dollar exchange rate result in reclassification of amounts from accumulated other comprehensive income (loss) to earnings to offset foreign currency transaction gains and losses recognized on the intercompany loans. The Company’s aggregate fair value of foreign currency swap arrangements was an asset of \$26 million as of January 31, 2009 and a liability of \$54 million as of February 2, 2008. The asset and liability are included in Other Assets and Other Long-term Liabilities, respectively, on the Consolidated Balance Sheets.

In March and June 2007, the Company entered into interest rate lock agreements designated as cash flow hedges to mitigate exposure to interest rate fluctuations on the anticipated future issuance of debt. In conjunction with the Company’s issuance of notes during July 2007, the interest rate locks were settled. Based on changes between the anticipated and actual amount and timing of the debt issuance, the Company concluded during the second quarter of 2007 that the interest rate locks no longer qualified as cash flow hedges. As a result, \$17 million of realized pre-tax gains from the settlement of the interest rate locks was recognized in earnings in the second quarter of 2007. The gain on the interest rate lock agreements is included in Other Income (Loss) on the 2007 Consolidated Statement of Income.

In January 2008, the Company entered into a participating interest rate swap arrangement designated as a cash flow hedge to mitigate exposure to interest rate fluctuations related to the Company's \$750 million term loan. The fair value of the participating interest rate swap arrangement was a liability of \$30 million as of January 31, 2009 and \$13 million as of February 2, 2008. The liability is included in Other Long-term Liabilities on the Consolidated Balance Sheets.

On February 3, 2008, the Company adopted SFAS 157 for financial assets and liabilities. The fair values of the derivative instruments are determined using valuation methodologies that employ Level 2 inputs as defined in SFAS 157.

## 5. Comprehensive Income (Loss)

Comprehensive Income (Loss) consists of gains and losses on derivative instruments and foreign currency translation adjustments. The cumulative gains and losses on these items are included in Accumulated Other Comprehensive Income (Loss) in the Consolidated Balance Sheets and Consolidated Statements of Shareholders' Equity.

The following table provides additional detail regarding the composition of Accumulated Other Comprehensive Income (Loss) as of January 31, 2009 and February 2, 2008:

|  | <u>January 31,</u><br><u>2009</u> | <u>February 2,</u><br><u>2008</u> |
|--|-----------------------------------|-----------------------------------|
|  | (in millions)                     |                                   |
| Foreign Currency Translation   | \$ (4)                            | \$ 30                             |
| Unrealized Gain (Loss) on Cross Currency Interest Rate Cash Flow Hedge | 26                                | (55)                              |
| Reclassification of Cash Flow Hedges to Earnings                       | (18)                              | 73                                |
| Unrealized Loss on Interest Rate Cash Flow Hedge                       | (29)                              | (13)                              |
| Realized Loss on Cash Flow Hedge                                       | (3)                               | (4)                               |
| <b>Total Accumulated Other Comprehensive (Loss) Income</b>             | <u>\$ (28)</u>                    | <u>\$ 31</u>                      |

## 6. Acquisitions, Divestitures and Other

### Acquisition

#### La Senza Corporation

On January 12, 2007, the Company completed the acquisition of 100% of the stock of La Senza Corporation ("La Senza") for \$600 million, including transaction costs of \$8 million. The acquisition was financed through the use of existing cash and was accounted for as a purchase, with results of operations included in the Consolidated Financial Statements since the date of acquisition. La Senza is a Canadian specialty retailer offering lingerie and sleepwear, as well as apparel for girls in the 7-14 year age group. In addition, La Senza licensees operate independently owned stores in 45 other countries. The acquisition of La Senza supports the Company's objective of enhancing its capabilities to pursue its strategic growth goals internationally.

### Divestitures

#### Joint Venture

In April 2008, the Company and its investment partner completed the divestiture of a joint venture, which the Company consolidated under the provisions of FIN 46(R) to a third party. The Company recognized a pre-tax gain of \$128 million and received pre-tax proceeds of \$168 million on the divestiture. The pre-tax gain is included in Net Gain on Joint Ventures on the 2008 Consolidated Statement of Income. Total proceeds included \$24 million which was to be held in escrow until August 2009 to cover any post-closing contingencies. In December 2008, \$15 million of the \$24 million in funds held in escrow were distributed to the Company.

#### Express

On July 6, 2007, the Company completed the divestiture of 75% of its ownership interest in Express to affiliates of Golden Gate Capital for pre-tax net cash proceeds of \$547 million. The Company recorded a pre-tax gain on the divestiture of \$302 million. For additional information, see Note 11, "Equity Investments and Other."

In conjunction with the transaction, the Company and Express entered into transition services agreements whereby the Company provides support to Express in various operational areas including logistics, technology and merchandise sourcing. The terms of these transition services arrangements varies and range from 3 months to 3 years. The Company recognized merchandise sourcing revenue from Express of \$435 million and \$353 million for 2008 and 2007, respectively. These amounts are net of the elimination of 25% of the gross merchandise sourcing revenue consistent with the Company's ownership percentage. The Company's

accounts receivable from Express for merchandise sourcing and other services provided in accordance with the terms and conditions of the transition services agreements totaled \$92 million and \$151 million as of January 31, 2009 and February 2, 2008, respectively.

#### Limited Stores

On August 3, 2007, the Company completed the divestiture of 75% of its ownership interest in Limited Stores to affiliates of Sun Capital. As part of the agreement, Sun Capital contributed \$50 million of equity capital into the business and arranged a \$75 million credit facility. The Company recorded a pre-tax loss on the divestiture of \$72 million. For additional information, see Note 11, "Equity Investments and Other."

In conjunction with the transaction, the Company and Limited Stores entered into transition services agreements whereby the Company provides support to Limited Stores in various operational areas including logistics, technology and merchandise sourcing. The terms of these transition services arrangements varies and range from 3 months to 3 years. The Company recognized merchandise sourcing revenue from Limited Stores of \$92 million and \$75 million for 2008 and 2007, respectively. These amounts are net of the elimination of 25% of the gross merchandise sourcing revenue consistent with the Company's ownership percentage. The Company's accounts receivable from Limited Stores for merchandise sourcing and other services provided in accordance with the terms and conditions of the transition services agreements totaled \$12 million and \$22 million as of January 31, 2009 and February 2, 2008, respectively.

### 7. Restructuring Activities

#### 2008

During the fourth quarter of 2008, the Company initiated a restructuring program designed to resize the Company's corporate infrastructure and to adjust for the impact of the current retail environment. This program resulted in the elimination of approximately 400 positions (or 10%) of the Company's corporate and home office headcount. The Company recognized a pre-tax charge consisting of severance and related costs of \$23 million for the fiscal year ended January 31, 2009. These costs are included in General, Administrative and Store Operating Expenses on the 2008 Consolidated Statement of Income.

#### 2007

In 2007, the Company completed a restructuring program designed to resize the Company's corporate infrastructure and to adjust for the impact of the Apparel divestitures. This program resulted in the elimination of approximately 500 positions (or 10%) of the Company's corporate and home office headcount through position eliminations and transfers to Express and Limited Stores. The Company recognized pre-tax charges consisting primarily of severance and related costs of \$34 million for the fiscal year ended February 2, 2008. These costs are included in General, Administrative and Store Operating Expenses on the 2007 Consolidated Statement of Income. The Company also recognized \$25 million in gains related to the sale of corporate aircraft. These gains are included in General, Administrative and Store Operating Expenses on the 2007 Consolidated Statement of Income.

### 8. Inventories

The following table provides inventories as of January 31, 2009 and February 2, 2008:

|  | January 31,<br>2009 | February 2,<br>2008 |
|--|---------------------|---------------------|
|  | (in millions)       |                     |
| Finished Goods Merchandise               | \$ 1,101            | \$ 1,140            |
| Raw Materials and Merchandise Components | 81                  | 111                 |
| <b>Total Inventories</b>                 | <b>\$ 1,182</b>     | <b>\$ 1,251</b>     |

During the second quarter of 2007, the Company recognized a pre-tax charge of \$19 million related to excess raw material and component inventory at Bath & Body Works. This cost was included in Cost of Goods Sold, Buying and Occupancy on the 2007 Consolidated Statement of Income.

## 9. Property and Equipment, Net

Property and Equipment, Net as of January 31, 2009 and February 2, 2008 were as follows:

|   | January 31,<br>2009 | February 2,<br>2008 |
|---|---------------------|---------------------|
|   | (in millions)       |                     |
| Land  | \$ 60               | \$ 60               |
| Buildings and Improvements                  | 392                 | 394                 |
| Furniture, Fixtures, Software and Equipment | 2,375               | 2,255               |
| Leaseholds and Improvements                 | 1,085               | 970                 |
| Construction in Progress                    | 119                 | 132                 |
| <b>Total</b>                                | <b>4,031</b>        | <b>3,811</b>        |
| Accumulated Depreciation and Amortization   | (2,102)             | (1,949)             |
| <b>Property and Equipment, Net</b>          | <b>\$ 1,929</b>     | <b>\$ 1,862</b>     |

Depreciation expense was \$371 million in 2008, \$371 million in 2007 and \$345 million in 2006.

## 10. Goodwill, Trade Names and Other Intangible Assets, Net

### Goodwill

The following table provides the rollforward of goodwill for the fiscal years ended January 31, 2009 and February 2, 2008:

|                                       | Victoria's<br>Secret | Bath &<br>Body Works | Other        | Total           |
|---------------------------------------|----------------------|----------------------|--------------|-----------------|
|                                       | (in millions)        |                      |              |                 |
| <b>Balance as of February 3, 2007</b> | <b>\$ 999</b>        | <b>\$ 628</b>        | <b>\$ 49</b> | <b>\$ 1,676</b> |
| Acquisitions                          | —                    | —                    | 25           | 25              |
| Reclassification to Trade Name        | —                    | —                    | (12)         | (12)            |
| Impairment                            | —                    | —                    | (13)         | (13)            |
| Reallocation of Purchase Price        | (1)                  | —                    | (1)          | (2)             |
| Foreign Currency Translation          | 59                   | —                    | —            | 59              |
| <b>Balance as of February 2, 2008</b> | <b>1,057</b>         | <b>628</b>           | <b>48</b>    | <b>1,733</b>    |
| Disposals                             | —                    | —                    | (48)         | (48)            |
| Impairment                            | (189)                | —                    | —            | (189)           |
| Foreign Currency Translation          | (70)                 | —                    | —            | (70)            |
| <b>Balance as of January 31, 2009</b> | <b>\$ 798</b>        | <b>\$ 628</b>        | <b>\$ —</b>  | <b>\$ 1,426</b> |

### Intangible Assets – Indefinite Lives

Intangible assets with indefinite lives represent the Victoria's Secret, Bath & Body Works and La Senza trade names. These assets totaled \$548 million as of January 31, 2009 and \$611 million as of February 2, 2008 and are included in Trade Names and Other Intangible Assets, Net on the Consolidated Balance Sheets.

## Intangible Assets – Finite Lives

The following table provides intangible assets with finite lives as of January 31, 2009 and February 2, 2008:

|   | January 31,<br>2009 | (in millions) | February 2,<br>2008 |
|---|---------------------|---------------|---------------------|
| Intellectual Property                           | \$ 41               |               | \$ 41               |
| Trademarks/Brands                               | 19                  |               | 45                  |
| Licensing Agreements and Customer Relationships | 21                  |               | 28                  |
| Favorable Operating Leases                      | 18                  |               | 22                  |
| <b>Total</b>                                    | <b>99</b>           |               | <b>136</b>          |
| Accumulated Amortization                        | (67)                |               | (70)                |
| <b>Intangible Assets, Net</b>                   | <b>\$ 32</b>        |               | <b>\$ 66</b>        |

Amortization expense was \$6 million for 2008, \$14 million for 2007 and \$11 million for 2006. Estimated future annual amortization expense will be approximately \$6 million in each of 2009, 2010 and 2011, \$3 million in 2012 and 2013 and \$8 million thereafter.

## Impairment Charges

### La Senza

In conjunction with the January 2007 acquisition of La Senza, the Company recorded \$313 million in goodwill, \$170 million in intangible assets with indefinite lives and \$26 million in intangible assets with finite lives. These assets are included in the La Senza reporting unit which is part of the Victoria's Secret reportable segment.

In the fourth quarter of 2008, the Company completed its annual impairment testing. During the latter half of 2008, La Senza's operating results were negatively impacted by the global economic downturn and the resulting impact on the Canadian retail environment. As part of the annual impairment evaluation, the Company assessed the recoverability of goodwill using a discounted cash flow methodology. The Company concluded that the carrying value of the La Senza goodwill exceeded the implied fair value based on the estimated fair value of the La Senza reporting unit. Accordingly, the Company recorded a goodwill impairment charge of \$189 million. The goodwill impairment charge is included in Impairment of Goodwill and Other Intangible Assets on the 2008 Consolidated Statement of Income.

Prior to completing the goodwill impairment evaluation, the Company performed its annual impairment analysis for indefinite-lived trade names. Based on its evaluation using a relief from royalty methodology, the Company concluded that certain La Senza trade name assets were impaired. Accordingly, the Company recorded an impairment charge of \$25 million to reduce the carrying value of these assets to their estimated fair values. The Company also recognized a \$1 million impairment charge related to a finite lived trade name asset. These impairment charges are included in Impairment of Goodwill and Other Intangible Assets on the 2008 Consolidated Statement of Income.

### Personal Care Joint Venture

In February 2007, the Company acquired a personal care products business along with an investment partner. Net assets of the acquired business consisted primarily of goodwill. During the second quarter of 2007, the Company and its investment partner made a decision to close the operations of the acquired business. Based on this decision, the Company completed a valuation of the acquired business trade name, which the Company continues to use. Based on the Company's evaluation, \$12 million of the \$25 million purchase price was allocated to the trade name. The remaining \$13 million was recognized as an impairment charge in the second quarter of 2007. The Company recognized the investment partner's portion of the impairment charge of \$6 million in Net Income (Loss) Attributable to Noncontrolling Interest on the 2007 Consolidated Statement of Income.

## 11. Equity Investments and Other

### Express

On July 6, 2007, the Company completed the divestiture of 75% of its ownership interest in Express to affiliates of Golden Gate Capital. The Company's remaining 25% investment in Express is accounted for under the equity method of accounting.

In March 2008, Express distributed cash to its owners and the Company received \$41 million. The Company's portion representing a return of capital is \$28 million and is included in Return of Capital from Express within the Investing Activities

section of the 2008 Consolidated Statement of Cash Flows. The remaining \$13 million is considered a return on capital and is included in Other Assets and Liabilities within the Operating Activities section of the 2008 Consolidated Statement of Cash Flows.

In July 2008, Express distributed additional cash to its owners and the Company received \$71 million. The Company's portion representing a return of capital is \$67 million with the remaining \$4 million representing a return on capital. The proceeds received from the cash distribution were in excess of the Company's carrying value of the investment in Express. As a result, the carrying value was reduced to zero as of the date of the cash distribution and a pre-tax gain of approximately \$13 million was recorded. The gain is included in Other Income on the 2008 Consolidated Statement of Income. The Company's investment carrying value for Express was zero as of January 31, 2009 and \$99 million as of February 2, 2008. These amounts are included in Other Assets on the Consolidated Balance Sheets.

#### **Limited Stores**

On August 3, 2007, the Company completed the divestiture of 75% of its ownership interest in Limited Stores to affiliates of Sun Capital. The Company's remaining 25% investment in Limited Stores is accounted for under the equity method of accounting. Accordingly, the Company recorded 25% of Limited Stores' results for the period from August 4, 2007 through January 31, 2009 in Other Income (Loss) on the Consolidated Statement of Income. The Company's investment carrying value for Limited Stores was \$12 million as of January 31, 2009 and \$13 million as of February 2, 2008 and is included in Other Assets on the Consolidated Balance Sheets.

#### **Easton Investment**

The Company has land and other investments in Easton, a 1,300 acre planned community in Columbus, Ohio that integrates office, hotel, retail, residential and recreational space. These investments, at cost, totaled \$63 million as of January 31, 2009 and \$62 million as of February 2, 2008 and are recorded in Other Assets on the Consolidated Balance Sheets.

Included in the Company's Easton investments is an equity interest in Easton Town Center, LLC ("ETC"), an entity that owns and has developed a commercial entertainment and shopping center. The Company's investment in ETC is accounted for using the equity method of accounting. The Company has a majority financial interest in ETC, but another unaffiliated member manages ETC. Certain significant decisions regarding ETC require the consent of unaffiliated members in addition to the Company.

In July 2007, ETC refinanced its \$290 million secured bank loan replacing it with a \$405 million secured bank loan. The loan is payable in full on August 9, 2017.

In conjunction with the loan refinancing, ETC repaid the existing loan, reserved cash for capital expenditures and operations and authorized the distribution of \$150 million to ETC members. As an ETC member, the Company received approximately \$102 million of proceeds resulting in a \$100 million gain after reducing the Company's ETC carrying value from \$2 million to zero. The gain is included in Other Income (Loss) on the 2007 Consolidated Statement of Income.

Total assets of ETC were approximately \$253 million as of January 31, 2009 and \$262 million as of February 2, 2008.

#### **Other**

In April 2008, the Company recorded a pre-tax impairment charge of \$19 million related to an unconsolidated joint venture accounted for under the equity method of accounting. The charge consisted of writing down the investment balance, reserving certain accounts and notes receivable and accruing a contractual liability. The impairment of \$19 million is included in Net Gain on Joint Ventures on the 2008 Consolidated Statement of Income.

## 12. Accrued Expenses and Other

The following table provides additional information about the composition of accrued expenses and other as of January 31, 2009 and February 2, 2008:

|   | January 31,<br>2009 | February 2,<br>2008 |
|---|---------------------|---------------------|
|   | (in millions)       |                     |
| Deferred Revenue , Principally from Gift Card Sales | \$ 166              | \$ 218              |
| Compensation, Payroll Taxes and Benefits            | 103                 | 115                 |
| Taxes, Other Than Income                            | 74                  | 71                  |
| Returns Reserve                                     | 35                  | 37                  |
| Insurance   | 34                  | 33                  |
| Rent  | 25                  | 31                  |
| Interest  | 31                  | 24                  |
| Current Portion of Long-term Debt                   | —                   | 7                   |
| Other   | 201                 | 185                 |
| <b>Total Accrued Expenses and Other</b>             | <b>\$ 669</b>       | <b>\$ 721</b>       |

## 13. Income Taxes

The following table provides the components of the Company's provision for income taxes for 2008, 2007 and 2006:

|                                   | 2008          | 2007         | 2006         |
|-----------------------------------|---------------|--------------|--------------|
|                                   | (in millions) |              |              |
| <b>Current:</b>                   |               |              |              |
| U.S. Federal                      | \$151         | \$352        | \$385        |
| U.S. State                        | 13            | 46           | 75           |
| Non-U.S.                          | 23            | 18           | 5            |
| <b>Total</b>                      | <b>187</b>    | <b>416</b>   | <b>465</b>   |
| <b>Deferred:</b>                  |               |              |              |
| U.S. Federal                      | 38            | 59           | (22)         |
| U.S. State                        | 15            | (56)         | (21)         |
| Non-U.S.                          | (7)           | (8)          | —            |
| <b>Total</b>                      | <b>46</b>     | <b>(5)</b>   | <b>(43)</b>  |
| <b>Provision for Income Taxes</b> | <b>\$233</b>  | <b>\$411</b> | <b>\$422</b> |

The foreign component of pre-tax income, arising principally from overseas operations, was a loss of \$90 million for 2008 which includes the impact of the \$215 million impairment of goodwill and other intangible assets and changes in transfer pricing. The foreign pre-tax income was \$40 million for 2007 and \$54 million for 2006. The non-U.S. tax provision reflects the impact of enacted statutory rate decreases in Canada.

The following table provides the reconciliation between the statutory federal income tax rate and the effective tax rate for 2008, 2007 and 2006:

|   | 2008         | 2007         | 2006         |
|---|--------------|--------------|--------------|
| Federal Income Tax Rate   | 35.0%        | 35.0%        | 35.0%        |
| State Income Taxes, Net of Federal Income Tax Effect              | 5.0%         | 3.5%         | 3.2%         |
| State Net Operating Loss and Valuation Allowance Adjustment       | 2.2%         | (3.4)%       | —            |
| Non-deductible Loss on Divestiture of Limited Stores              | —            | 1.9%         | —            |
| Non-deductible Impairment of Goodwill and Other Intangible Assets | 14.2%        | —            | —            |
| Other Items, Net  | (4.9)%       | (0.6)%       | 0.3%         |
| <b>Effective Tax Rate</b>   | <b>51.5%</b> | <b>36.4%</b> | <b>38.5%</b> |

The Company's effective tax rate has historically reflected and continues to reflect a provision related to the undistributed earnings of foreign affiliates. The Company has recorded a deferred tax liability for those amounts, but the taxes are not paid until the earnings are deemed repatriated to the United States.

## Deferred Taxes

The following table provides the effect of temporary differences that cause deferred income taxes as of January 31, 2009 and February 2, 2008. Deferred tax assets and liabilities represent the future effects on income taxes resulting from temporary differences and carryforwards at the end of the respective year.

|  | January 31, 2009 |                 |                        | February 2, 2008 |                 |                |
|--|------------------|-----------------|------------------------|------------------|-----------------|----------------|
|  | Assets           | Liabilities     | Total<br>(in millions) | Assets           | Liabilities     | Total          |
| Leases                                       | \$ 33            | \$ —            | \$ 33                  | \$ 24            | \$ —            | \$ 24          |
| Non-qualified Retirement Plan                | 62               | —               | 62                     | 66               | —               | 66             |
| Inventory                                    | 47               | —               | 47                     | 51               | —               | 51             |
| Property and Equipment                       | —                | (153)           | (153)                  | —                | (82)            | (82)           |
| Goodwill                                     | —                | (15)            | (15)                   | —                | (16)            | (16)           |
| Trade Names and Other Intangibles            | —                | (182)           | (182)                  | —                | (203)           | (203)          |
| Undistributed Earnings of Foreign Affiliates | —                | (13)            | (13)                   | —                | (21)            | (21)           |
| State Net Operating Losses                   | 32               | —               | 32                     | 47               | —               | 47             |
| Non-U.S. Operating Losses                    | 21               | —               | 21                     | 13               | —               | 13             |
| Valuation Allowance                          | (28)             | —               | (28)                   | (20)             | —               | (20)           |
| Other, Net                                   | 59               | —               | 59                     | 37               | —               | 37             |
| <b>Total Deferred Income Taxes</b>           | <b>\$226</b>     | <b>\$ (363)</b> | <b>\$(137)</b>         | <b>\$218</b>     | <b>\$ (322)</b> | <b>\$(104)</b> |

As of January 31, 2009, the Company had available for state income tax purposes net operating loss carryforwards which expire, if unused, in the years 2009 through 2026. The Company has analyzed the realization of the state net operating loss carryforwards on an individual state basis. In the second quarter of 2007, a substantial portion of the valuation allowance was reversed in connection with the Apparel divestitures. For those states where the Company has determined that it is more likely than not that the state net operating loss carryforwards will not be realized, a valuation allowance has been provided for the deferred tax asset.

As of January 31, 2009, the Company had available for non-U.S. tax purposes net operating loss carryforwards which expire, if unused, in the years 2028 and 2029. The Company has determined that it is more likely than not that all of the net operating loss carryforwards will not be realized and a valuation allowance has been provided for the net deferred tax assets, including the net operating loss carryforwards, of the related tax loss entity.

Income taxes payable on the accompanying Consolidated Balance Sheets included net current deferred tax liabilities of \$2 million as of January 31, 2009 and \$4 million as of February 2, 2008. The Company also had net current deferred tax assets of \$78 million and \$75 million as of as of January 31, 2009 and February 2, 2008, respectively, which are included in Other Current Assets on the Consolidated Balance Sheets. Income tax payments were \$205 million for 2008, \$428 million for 2007 and \$451 million for 2006.

## Uncertain Tax Positions

Effective February 4, 2007, the Company adopted Financial Accounting Standards Board Interpretation 48, *Accounting for Uncertainty in Income Taxes* ("FIN 48"), an interpretation of FASB Statement 109. FIN 48 requires that a position taken or expected to be taken in a tax return be recognized in the financial statements when it is more likely than not (i.e., a likelihood of more than fifty percent) that the position would be sustained upon examination by tax authorities. A recognized tax position is then measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. Upon adoption, the Company recognized an additional \$10 million liability for unrecognized tax benefits, which was accounted for as a reduction to the Company's opening balance of retained earnings on February 4, 2007. Including this adjustment, the Company had \$131 million of unrecognized tax benefits as of February 4, 2007, \$85 million of which, if recognized, would reduce the effective income tax rate and \$6 million of which, if recognized, would reduce Goodwill. Additionally, the Company reclassified \$107 million of unrecognized tax benefits from Current Liabilities—Income Taxes to Other Long-term Liabilities on the Consolidated Balance Sheet.

The Company had unrecognized tax benefits of \$164 million and \$144 million as of January 31, 2009 and February 2, 2008, respectively, of which \$95 million and \$97 million would reduce the effective income tax rate for 2008 and 2007, respectively. Of the total unrecognized tax benefits, it is reasonably possible that \$41 million could change in the next twelve months due to audit



settlements, expiration of statute of limitations or other resolution of uncertainties. Due to the uncertain and complex application of tax regulations, it is possible that the ultimate resolution of audits may result in liabilities which could be different from this estimate. In such case, the Company will record additional tax expense or tax benefit in the tax provision or reclassify amounts on the Consolidated Balance Sheet in the period in which such matter is effectively settled with the tax authority.

The Company recognizes interest and penalties related to unrecognized tax benefits as components of income tax expense. For 2008, \$7 million of interest and penalties was included in the Provision for Income Tax. The Company has accrued approximately \$47 million and \$40 million for the payment of interest and penalties as of January 31, 2009 and February 2, 2008, respectively.

The following table summarizes the activity related to its unrecognized tax benefits for U.S. federal, state & non-U.S. tax jurisdictions for 2008 and 2007 without interest and penalties:

|  | <u>2008</u>   | <u>2007</u>  |
|--|---------------|--------------|
|  | (in millions) |              |
| <b>Gross Unrecognized Tax Benefits, as of the Beginning of the Fiscal Year</b>                         | \$104         | \$ 92        |
| Increases in Tax Positions for Prior Years   | 16            | 6            |
| Decreases in Tax Positions for Prior Years   | (18)          | (14)         |
| Increases in Unrecognized Tax Benefits as a Result of Current Year Activity                            | 23            | 28           |
| Decreases to Unrecognized Tax Benefits Relating to Settlements with Taxing Authorities                 | (3)           | (5)          |
| Decreases to Unrecognized Tax Benefits as a Result of a Lapse of the Applicable Statute of Limitations | (5)           | (4)          |
| Foreign Currency Translation   | (1)           | 1            |
| <b>Gross Unrecognized Tax Benefits, as of the End of the Fiscal Year</b>                               | <u>\$116</u>  | <u>\$104</u> |

The Company files U.S. federal income tax returns as well as income tax returns in various states and in non-U.S. jurisdictions. At the end of 2008, the Company was subject to examination by the IRS for calendar years 2006 through 2008. The Company is also subject to various U.S. state and local income tax examinations for the years 1999 to 2008. Finally, the Company is subject to multiple non-U.S. tax jurisdiction examinations for the years 2000 to 2008. In some situations, the Company determines that it does not have a filing requirement in a particular tax jurisdiction. Where no return has been filed, no statute of limitations applies. Accordingly, if a tax jurisdiction reaches a conclusion that a filing requirement does exist, additional years may be reviewed by the tax authority. The Company believes it has appropriately accounted for uncertainties related to this issue.

#### 14. Long-term Debt

The following table provides the Company's long-term debt balance as of January 31, 2009 and February 2, 2008:

|   | <u>January 31,</u> | <u>February 2,</u> |
|---|--------------------|--------------------|
|   | (in millions)      |                    |
|   | 2009               | 2008               |
| Term Loan due August 2012. Variable Interest Rate of 3.99% as of January 31, 2009             | \$ 750             | \$ 750             |
| \$700 million, 6.90% Fixed Interest Rate Notes due July 2017, Less Unamortized Discount       | 698                | 698                |
| \$500 million, 5.25% Fixed Interest Rate Notes due November 2014, Less Unamortized Discount   | 499                | 499                |
| \$350 million, 6.95% Fixed Interest Rate Debentures due March 2033, Less Unamortized Discount | 350                | 350                |
| \$300 million, 7.60% Fixed Interest Rate Notes due July 2037, Less Unamortized Discount       | 299                | 299                |
| \$300 million, 6.125% Fixed Interest Rate Notes due December 2012, Less Unamortized Discount  | 299                | 299                |
| Credit Facility due January 2010  | —                  | 15                 |
| 5.30% Mortgage due August 2010  | 2                  | 2                  |
| <b>Total</b>  | <u>2,897</u>       | <u>2,912</u>       |
| Current Portion of Long-term Debt   | —                  | (7)                |
| <b>Total Long-term Debt, net of Current Portion</b>   | <u>\$ 2,897</u>    | <u>\$ 2,905</u>    |

In July 2007, the Company issued \$700 million of 6.90% notes due July 15, 2017 and \$300 million of 7.60% notes due July 15, 2037 utilizing a shelf registration statement under which up to \$1 billion of debt securities, common and preferred stock and other securities could be issued. Interest on the notes is payable on January 15 and July 15 of each year.

On August 3, 2007, the Company amended the October 2004 \$500 million term loan agreement to increase the borrowing capacity to \$750 million and extend the term to August 2012. During the second quarter of 2007, the Company borrowed the additional \$250 million under the term loan agreement.

On August 3, 2007, the Company amended its \$1 billion unsecured revolving credit facility (the “5-Year Facility”) by extending its term to August 2012 and executed a \$500 million, 364-day unsecured revolving credit facility (the “364-Day Facility”). On July 11, 2008, the Company renewed the 364-Day Facility and reduced its size to \$300 million. Both facilities support the Company’s commercial paper and letter of credit programs. As of January 31, 2009, there were no borrowings outstanding under either facility and no commercial paper outstanding. Fees payable under the 5-Year Facility are based on the Company’s long-term credit ratings and were 0.15% of the committed amount per year as of January 31, 2009. Fees payable under the 364-Day Facility are also based on the Company’s long-term credit ratings and were 0.35% of the committed amount per year as of January 31, 2009.

In January 2006, Mast Industries (Far East) Limited, a wholly owned subsidiary of Limited Brands, Inc., entered into a \$60 million unsecured revolving credit facility. During 2006, \$30 million was drawn on the facility while the remaining \$30 million expired in March 2006. The credit facility was available for general corporate purposes including the funding of dividends to Limited Brands, Inc. Borrowings under the credit facility are due in equal semi-annual installments through the maturity date of the credit facility in January 2010. In October 2008, the Company repaid the Credit Facility due January 2010 and the related current portion of long-term debt.

The facilities and the Term Loan have several interest rate options, which are based in part on the Company’s long-term credit ratings. These agreements also require the Company to maintain certain specified fixed charge coverage and leverage ratios and prohibit certain types of liens on property or assets. The Company was in compliance with the covenant requirements as of January 31, 2009.

In January 2008, the Company entered into a participating interest rate swap arrangement designated as a cash flow hedge to mitigate exposure to interest rate fluctuations related to the Term Loan. The participating interest rate swap limits the Company’s exposure to increases in the benchmark interest rate while allowing the Company to partially participate in any decreases in the benchmark interest rate. For additional information, See Note 4, “Derivative Instruments.”

On February 19, 2009, the Company amended its 5-Year Facility, amended its Term Loan and canceled its 364-Day Facility. For additional information, see Note 22, “Subsequent Event.”

The following table provides principal payments due on long-term debt in the next five fiscal years and the remaining years thereafter:

| <u>Fiscal Year (in millions)</u> |       |
|----------------------------------|-------|
| 2009                             | \$ —  |
| 2010                             | 2     |
| 2011                             | —     |
| 2012                             | 1,050 |
| 2013                             | —     |
| Thereafter                       | 1,850 |

Cash paid for interest was \$174 million in 2008, \$151 million in 2007 and \$100 million in 2006.

#### 15. Fair Value of Financial Instruments

SFAS 107, *Disclosures about Fair Value of Financial Instruments* (“SFAS 107”), requires management to disclose the estimated fair value of certain assets and liabilities defined by SFAS 107 as financial instruments. As of January 31, 2009, management believes that the carrying values of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses approximate fair value because of their short maturity.

Quoted market prices in active markets are the best evidence of fair value and are used as the basis for the measurement, if available. In the absence of quoted prices for identical or similar assets or investments in active markets, fair value is estimated using various valuation methods including cash flow analysis and appraisals.

The estimated fair value of the Company’s long-term debt was \$2.1 billion compared to the carrying value of \$2.9 billion as of January 31, 2009. As of February 2, 2008, the estimated fair value of the Company’s long-term debt was \$2.8 billion compared to the carrying value of \$2.9 billion. The estimated fair value of the Company’s publicly traded debt is based on quoted market prices. The estimated fair value of the \$750 million term loan is equal to its carrying value. On February 19, 2009, the terms of the Term Loan were amended. The estimates presented are not necessarily indicative of the amounts that could be realized in a current market exchange.

The aggregate estimated fair value of the Company’s foreign currency swap arrangements was an asset of \$26 million as of January 31, 2009 and a liability of \$54 million as of February 2, 2008. The estimated fair value of the Company’s participating interest rate swap arrangement was a liability of \$30 million as of January 31, 2009 and \$13 million as of February 2, 2008.

## 16. Leases

The Company is committed to noncancelable leases with remaining terms generally from one to ten years. A substantial portion of the Company's leases consist of store leases generally with an initial term of ten years. Annual store rent consists of a fixed minimum amount and/or contingent rent based on a percentage of sales exceeding a stipulated amount. Store lease terms generally require additional payments covering taxes, common area costs and certain other expenses. These additional payments are excluded from the table below.

The following table provides rent expense for 2008, 2007 and 2006:

|                             | <u>2008</u>   | <u>2007</u>  | <u>2006</u>  |
|-----------------------------|---------------|--------------|--------------|
|                             | (in millions) |              |              |
| <b>Store Rent:</b>          |               |              |              |
| Fixed Minimum               | \$391         | \$431        | \$495        |
| Contingent                  | 37            | 58           | 72           |
| <b>Total Store Rent</b>     | <u>428</u>    | <u>489</u>   | <u>567</u>   |
| Office, Equipment and Other | 64            | 70           | 50           |
| <b>Gross Rent Expense</b>   | <u>492</u>    | <u>559</u>   | <u>617</u>   |
| Sublease Rental Income      | (4)           | (9)          | (14)         |
| <b>Total Rent Expense</b>   | <u>\$488</u>  | <u>\$550</u> | <u>\$603</u> |

The following table provides the Company's minimum rent commitments under noncancelable operating leases in the next five fiscal years and the remaining years thereafter:

| <u>Fiscal Year (in millions) (a)</u> |        |
|--------------------------------------|--------|
| 2009                                 | \$ 478 |
| 2010                                 | 455    |
| 2011                                 | 416    |
| 2012                                 | 373    |
| 2013                                 | 341    |
| Thereafter                           | 1,334  |

(a) Excludes additional payments covering taxes, common area costs and certain other expenses generally required by store lease terms.

The Company's future sublease income under noncancelable subleases was \$14 million as of January 31, 2009, which included \$3 million of rent commitments related to disposed businesses under master lease arrangements.

## 17. Commitments and Contingencies

The Company is subject to various claims and contingencies related to lawsuits, taxes, insurance, regulatory and other matters arising out of the normal course of business. Management believes that the ultimate liability arising from such claims and contingencies, if any, is not likely to have a material adverse effect on the Company's results of operations, financial condition or cash flows.

### Guarantees

In connection with the disposition of certain businesses, the Company has remaining guarantees of approximately \$194 million related to lease payments of Express, Limited Stores, Abercrombie & Fitch, Tween Brands (formerly Limited Too and Too, Inc.), Dick's Sporting Goods (formerly Galyan's), Lane Bryant, New York & Company and Anne.x under the current terms of noncancelable leases expiring at various dates through 2019. These guarantees include minimum rent and additional payments covering taxes, common area costs and certain other expenses and relate to leases that commenced prior to the disposition of the businesses. In certain instances, the Company's guarantee may remain in effect if the term of a lease is extended.

In April 2008, the Company received an irrevocable standby letter of credit from Express of \$34 million issued by a third-party bank to mitigate a portion of the Company's contingent liability for guaranteed future lease payments of Express. The Company can draw from the irrevocable standby letter of credit if Express were to default on any of the guaranteed leases. The irrevocable standby letter of credit is reduced through September 30, 2010, the expiration date of the letter of credit, consistent with the overall reduction in guaranteed lease payments. The outstanding balance of the irrevocable standby letter of credit from Express was \$19 million as of January 31, 2009.

The Company's guarantees related to Express, Limited Stores and New York & Company are subject to the provisions of SFAS 145, *Rescission, Amendment and Technical Correction of Certain Accounting Standards*, which requires fair value accounting for these guarantee obligations. The guaranteed lease payments related to Express (net of the irrevocable standby letter of credit), Limited Stores and New York & Company totaled \$94 million and \$180 million as of January 31, 2009 and February 2, 2008, respectively. The estimated fair value of these guarantee obligations was \$15 million and \$10 million as of January 31, 2009 and February 2, 2008, respectively, and is included in Other Long-term Liabilities on its Consolidated Balance Sheets. The increase in the fair value from February 2, 2008 to January 31, 2009 reflects the impact of the current economic environment and the Company's assessment of the risk of default on the guaranteed lease payments.

The Company's guarantees related to Abercrombie & Fitch, Tween Brands (formerly Limited Too and Too, Inc.), Dick's Sporting Goods (formerly Galyan's), Lane Bryant and Anne.x are not subject to the fair value provisions of SFAS 145 because they were executed prior to the effective date of SFAS 145. These guarantees are subject to the provisions of SFAS 5, *Accounting for Contingencies*, which requires that a loss be accrued when probable and reasonably estimable. As of January 31, 2009 and February 2, 2008, the Company had no liability recorded with respect to any of the guarantee obligations subject to SFAS 5 as it concluded that performance under these guarantees was not probable.

## **18. Retirement Benefits**

The Company sponsors a tax-qualified defined contribution retirement plan and a non-qualified supplemental retirement plan for substantially all of its associates within the United States of America. Participation in the tax-qualified plan is available to associates who meet certain age and service requirements. Participation in the non-qualified plan is made available to associates who meet certain age, service, job level and compensation requirements.

The qualified plan permits associates to elect contributions up to the maximum limits allowable under the Internal Revenue Code. The Company matches associate contributions according to a predetermined formula and contributes additional amounts based on a percentage of the associates' eligible annual compensation and years of service. Associate contributions and Company matching contributions vest immediately. Additional Company contributions and the related investment earnings are subject to vesting based on years of service. Total expense recognized related to the qualified plan was \$40 million for 2008, \$44 million for 2007 and \$49 million for 2006.

The non-qualified plan is an unfunded plan which provides benefits beyond the Internal Revenue Code limits for qualified defined contribution plans. The plan permits associates to elect contributions up to a maximum percentage of eligible compensation. The Company matches associate contributions according to a predetermined formula and credits additional amounts based on a percentage of the associates' eligible compensation and years of service. The plan also permits associates to defer additional compensation up to a maximum amount which the Company does not match. Associates' accounts are credited with interest using a rate determined by the Company. Associate contributions and the related interest vest immediately. Company contributions and credits, along with related interest, are subject to vesting based on years of service. Associates may elect in-service distributions for the unmatched additional deferred compensation component only. The remaining vested portion of associates' accounts in the plan will be distributed upon termination of employment in either a lump sum or in equal annual installments over a specified period of up to 10 years.

The following table provides the Company's annual activity for this plan and year-end liability, included in Other Long-term Liabilities on the Consolidated Balance Sheets, as of January 31, 2009 and February 2, 2008:

|                                     | January 31,<br>2009 | February 2,<br>2008 |
|-------------------------------------|---------------------|---------------------|
|                                     | (in millions)       |                     |
| <b>Balance at Beginning of Year</b> | \$ 175              | \$ 179              |
| Contributions:                      |                     |                     |
| Associate                           | 9                   | 14                  |
| Company                             | 9                   | 11                  |
| Interest                            | 13                  | 11                  |
| Distributions                       | (39)                | (32)                |
| Transfers (a)                       | —                   | (8)                 |
| <b>Balance at End of Year</b>       | <u>\$ 167</u>       | <u>\$ 175</u>       |

(a) Reflects transfers to the plans established by Express and Limited Stores.

Total expense recognized related to the non-qualified plan was \$21 million for 2008, \$22 million for 2007 and \$26 million for 2006.

## 19. Total Equity

Under the authority of the Company's Board of Directors, the Company repurchased shares of its common stock under the following repurchase programs during the fiscal years ended January 31, 2009, February 2, 2008 and February 3, 2007:

|                                 | Amount<br>Authorized<br>(in millions) | Shares Repurchased |               |              | Average Stock<br>Price of Shares<br>Repurchased within<br>Program |
|---------------------------------|---------------------------------------|--------------------|---------------|--------------|---|
|                                 |                                       | 2008               | 2007          | 2006         |   |
|                                 |                                       | (in thousands)     |               |              |   |
| October 2008 (a)                | \$ 250                                | 19,048             | —             | —            | \$ 11.48  |
| November 2007 (b)               | 250                                   | 8,539              | 5,887         | —            | 17.33   |
| August 2007                     | 250                                   | —                  | 11,870        | —            | 21.06   |
| June 2007                       | 1,000                                 | —                  | 38,656        | —            | 25.87   |
| June 2006 (c)                   | 100                                   | —                  | 2,296         | 1,494        | 26.35   |
| February 2006                   | 100                                   | —                  | —             | 3,990        | 25.09   |
| November 2005 (d)               | 200                                   | —                  | —             | 1,795        | 22.82   |
| <b>Total Shares Repurchased</b> |                                       | <u>27,587</u>      | <u>58,709</u> | <u>7,279</u> |   |

(a) The repurchase program authorized in October 2008 had \$31 million remaining as of January 31, 2009.

(b) The repurchase program authorized in November 2007 had repurchases of \$150 million in 2008 at an average stock price of \$17.54 and repurchases of \$100 million in 2007 at an average stock price of \$17.02. This repurchase program was completed in May 2008.

(c) The repurchase program authorized in June 2006 had repurchases of \$59 million in 2007 at an average stock price of \$25.86 and repurchases of \$41 million in 2006 at an average stock price of \$27.11. This repurchase program was completed in May 2007.

(d) The repurchase program authorized in November 2005 had repurchases of \$42 million in 2006 at an average stock price of \$23.40 and repurchases of \$158 million in 2005 at an average stock price of \$22.67. This repurchase program was completed in February 2006.

For the November 2007 repurchase program, \$8 million of share repurchases were reflected in accounts payable as of February 2, 2008 and were settled in February 2008. For the October 2008 repurchase program, there were no share repurchases reflected in accounts payable as of January 31, 2009. Through March 20, 2009, no additional shares were repurchased.

## 20. Share-Based Compensation

### Plan Summary

The 1993 Stock Option and Performance Incentive Plan as amended (the “Plan”), which is shareholder approved, provides for the grant of incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock, performance-based restricted stock, performance units and unrestricted shares. The Company grants stock options at a price equal to the fair market value of the stock on the date of grant. Stock options have a maximum term of ten years. Stock options generally vest over 4 years with 25% vesting each year. Restricted stock generally vests (the restrictions lapse) over a two to three year period.

The Limited Brands, Inc. Stock Award and Deferred Compensation Plan for Non-Associate Directors provides for an annual stock retainer for non-associate directors. The stock issued in conjunction with this plan has no restrictions.

Under the Company’s plans, approximately 100 million options, restricted and unrestricted shares have been authorized to be granted to employees and directors. Approximately 17 million options and shares were available for grant as of January 31, 2009.

### Stock Options

The following table provides the Company’s stock option activity for the fiscal year ended January 31, 2009:

|  | <u>Number of<br/>Shares</u><br>(in thousands) | <u>Weighted<br/>Average Option<br/>Price Per Share</u> | <u>Weighted<br/>Average<br/>Remaining<br/>Contractual Life</u><br>(in years) | <u>Aggregate<br/>Intrinsic Value</u><br>(in thousands) |
|--|---|--|--|--|
| Outstanding as of February 2, 2008                     | 17,841  | \$ 19.60   |  |  |
| Granted  | 2,066   | 17.09  |  |  |
| Exercised  | (2,186)                                       | 14.31  |  |  |
| Cancelled  | (2,340)                                       | 22.17  |  |  |
| Outstanding as of January 31, 2009                     | <u>15,381</u>                                 | \$ 19.62   | 5.39   | \$ —   |
| Vested and Expected to Vest as of January 31, 2009 (a) | 14,516  | \$ 19.59   | 5.23   | \$ —   |
| Options Exercisable as of January 31, 2009             | 11,228  | \$ 19.06   | 4.39   | \$ —   |

(a) The number of options expected to vest includes an estimate of expected forfeitures.

Intrinsic value for stock options is the difference between the current market value of the Company’s stock and the option strike price. The total intrinsic value of options exercised was \$10 million for 2008, \$80 million for 2007 and \$130 million for 2006.

The total fair value at grant date of option awards vested was \$13 million for 2008, \$23 million for 2007 and \$39 million for 2006.

The Company’s total unrecognized compensation cost, net of estimated forfeitures, related to nonvested options was \$8 million as of January 31, 2009. This cost is expected to be recognized over a weighted-average period of 2 years.

The weighted-average estimated fair value of stock options granted was \$3.47 per share for 2008, \$6.97 per share for 2007 and \$7.61 per share for 2006.

Cash received from stock options exercised was \$31 million for 2008, \$74 million for 2007 and \$153 million for 2006. Tax benefits realized from tax deductions associated with stock options exercised were \$5 million for 2008, \$30 million for 2007 and \$50 million for 2006.

The Company uses the Black-Scholes option-pricing model (“Black-Scholes model”) for valuation of options granted to employees and directors. The Company’s determination of the fair value of options is affected by the Company’s stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to, the Company’s expected stock price volatility over the term of the awards and projected employee stock option exercise behaviors.

The following table contains the weighted-average assumptions used during 2008, 2007 and 2006:

|                          | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|--------------------------|-------------|-------------|-------------|
| Expected Volatility      | 29%         | 32%         | 35%         |
| Risk-free Interest Rate  | 2.5%        | 4.5%        | 4.8%        |
| Dividend Yield           | 3.4%        | 3.0%        | 2.9%        |
| Expected Life (in years) | 5.2         | 5.3         | 5.5         |

The expected volatility assumption is based on the Company's analysis of historical volatility. The risk-free interest rate assumption is based upon the average daily closing rates during the period for U.S. treasury notes that have a life which approximates the expected life of the option. The dividend yield assumption is based on the Company's history and expectation of dividend payouts. The expected life of employee stock options represents the weighted-average period the stock options are expected to remain outstanding.

#### *Restricted Stock*

The following table provides the Company's restricted stock activity for the fiscal year ended January 31, 2009:

|  | <u>Number of<br/>Shares<br/>(in thousands)</u> | <u>Weighted<br/>Average<br/>Grant Date<br/>Fair Value</u> |
|--|--|---|
| <b>Unvested as of February 2, 2008</b> | 3,370  | \$ 22.83  |
| Granted                                | 4,406  | 15.11   |
| Vested                                 | (887)  | 21.84   |
| Cancelled                              | (676)  | 21.83   |
| <b>Unvested as of January 31, 2009</b> | <u>6,213</u>                                   | <u>17.60</u>  |

The Company's total intrinsic value of restricted stock vested was \$15 million for 2008, \$11 million for 2007 and \$14 million for 2006.

The Company's total fair value at grant date of awards vested was \$19 million for 2008, \$8 million for 2007 and \$10 million for 2006. Fair value of restricted stock awards is based on the market value of an unrestricted share on the grant date adjusted for anticipated dividend yields.

Beginning in 2006, the Company issued performance-based restricted stock awards. The fair value of these shares is measured on the date that the performance goals and the target number of shares are communicated. The final number of shares of performance-based restricted stock issued to each employee is determined at the end of each Spring and Fall selling seasons, based upon performance against specified financial goals. The vesting period of these awards ranges from two to three years.

As of January 31, 2009, there was \$28 million of total unrecognized compensation cost, net of estimated forfeitures, related to unvested restricted stock. That cost is expected to be recognized over a weighted-average period of 2.3 years.

Tax benefits realized from tax deductions associated with restricted stock vested were \$6 million for 2008, \$5 million for 2007 and \$4 million for 2006.

#### *Income Statement Impact*

Total pre-tax share-based compensation expense recognized under SFAS 123(R) was \$35 million for 2008, \$44 million for 2007 and \$37 million for 2006. The tax benefit associated with share-based compensation was \$11 million for 2008, \$14 million for 2007 and \$11 million for 2006.

The following table provides share-based compensation expense included in the Consolidated Statements of Income for 2008, 2007 and 2006:

|  | <u>2008</u> | <u>2007</u><br>(in millions) | <u>2006</u> |
|--|-------------|------------------------------|-------------|
| Costs of Goods Sold, Buying and Occupancy            | \$11        | \$10                         | \$ 8        |
| General, Administrative and Store Operating Expenses | 24          | 34                           | 29          |
| Total Share-based Compensation Expense               | <u>\$35</u> | <u>\$44</u>                  | <u>\$37</u> |

## 21. Segment Information

Prior to the divestitures of Express and Limited Stores in the second quarter of 2007, the Company had three reportable segments: Victoria's Secret, Bath & Body Works and Apparel. The Victoria's Secret reportable segment consists of the Victoria's Secret and La Senza operating segments which are aggregated in accordance with the provisions of SFAS 131, *Disclosures about Segments of an Enterprise and Related Information*.

The Victoria's Secret segment sells women's intimate and other apparel, personal care and beauty products, and accessories under the Victoria's Secret, Pink and La Senza brand names. Victoria's Secret merchandise is sold through retail stores, its website, [www.VictoriasSecret.com](http://www.VictoriasSecret.com), and its catalogue. Through its website and catalogue, certain of Victoria's Secret's merchandise may be purchased worldwide. La Senza sells merchandise through retail stores located throughout Canada and licensed stores in 45 other countries. La Senza products may also be purchased through its website, [www.LaSenza.com](http://www.LaSenza.com).

The Bath & Body Works segment sells personal care, beauty and home fragrance products marketed under the Bath & Body Works, C.O. Bigelow and White Barn Candle Company brand names in addition to sales of third-party brands. Bath & Body Works merchandise is sold at retail stores, through its website, [www.bathandbodyworks.com](http://www.bathandbodyworks.com), and its catalogue.

The Apparel segment sold women's and men's apparel through Express and Limited Stores. After the closing dates of the divestitures, the segment no longer exists. However, the Company retains a 25% ownership interest in Express and Limited Stores.

Other consists of the following:

- Henri Bendel, operator of five specialty stores which feature accessories, fashion and personal care products;
- Bath & Body Works Canada, operator of six specialty stores which feature personal care, beauty and home fragrance products;
- Mast, an apparel merchandise sourcing and production company serving Victoria's Secret, La Senza and third-party customers;
- Beauty Avenues, a personal care sourcing and production company serving Victoria's Secret, La Senza and Bath & Body Works; and
- Corporate functions including non-core real estate, equity investments and other governance functions such as treasury and tax.



The following table provides the Company's segment information as of and for the fiscal years ended January 31, 2009, February 2, 2008 and February 3, 2007:

|                                 | Victoria's<br>Secret | Bath &<br>Body Works | Apparel (a)<br>(in millions) | Other   | Total    |
|---------------------------------|----------------------|----------------------|------------------------------|---------|----------|
| <b>January 31, 2009</b>         |                      |                      |                              |         |          |
| Net Sales                       | \$ 5,604             | \$ 2,374             | \$ —                         | \$1,065 | \$ 9,043 |
| Depreciation and Amortization   | 154                  | 66                   | —                            | 123     | 343      |
| Operating Income (Loss)         | 405                  | 215                  | —                            | (31)    | 589      |
| Total Assets                    | 3,086                | 1,446                | —                            | 2,440   | 6,972    |
| Capital Expenditures            | 279                  | 92                   | —                            | 108     | 479      |
| <b>February 2, 2008</b>         |                      |                      |                              |         |          |
| Net Sales                       | \$ 5,607             | \$ 2,494             | \$ 870                       | \$1,163 | \$10,134 |
| Depreciation and Amortization   | 156                  | 59                   | 27                           | 110     | 352      |
| Operating Income (Loss) (b) (c) | 718                  | 302                  | 250                          | (160)   | 1,110    |
| Total Assets                    | 3,365                | 1,456                | —                            | 2,616   | 7,437    |
| Capital Expenditures            | 315                  | 112                  | 37                           | 285     | 749      |
| <b>February 3, 2007</b>         |                      |                      |                              |         |          |
| Net Sales                       | \$ 5,139             | \$ 2,556             | \$ 2,242                     | 734     | 10,671   |
| Depreciation and Amortization   | 105                  | 52                   | 66                           | 93      | 316      |
| Operating Income (Loss) (c)     | 879                  | 420                  | (1)                          | (122)   | 1,176    |
| Total Assets                    | 3,221                | 1,516                | 622                          | 1,734   | 7,093    |
| Capital Expenditures            | 160                  | 87                   | 66                           | 235     | 548      |

- (a) Results of Express and Limited Stores are included through July 6, 2007 and August 3, 2007, respectively, when the businesses were divested. Total assets for the Apparel segment as of February 2, 2008 are not included as the businesses were divested prior to that date.
- (b) Operating income for Apparel for the fiscal year ended February 2, 2008 includes the gain on divestiture of Express of \$302 million and the loss on divestiture of Limited Stores of \$72 million.
- (c) Amounts presented are restated to conform with the corporate cost allocation methodology adopted at the beginning of 2008.

In 2007, the Company reviewed its corporate organization and allocation methodology as a result of changes in its business including the divestitures of Express and Limited Stores. Consistent with these business changes, the Company has transferred certain individuals and functions from corporate to its operating business units. Beginning in 2008, the Company changed its methodology for allocating certain remaining corporate costs to its operating business units, including, but not limited to, costs related to store real estate and store design and construction activities. This change primarily impacted General, Administrative and Store Operating Expenses across the Company's segments.

The Company's international sales, including La Senza, Bath & Body Works Canada and direct sales shipped internationally totaled \$655 million in 2008, \$611 million in 2007 and \$100 million in 2006. The Company's internationally based long-lived assets were \$364 million as of January 31, 2009 and \$713 million as of February 2, 2008.

## 22. Subsequent Event

On February 19, 2009, the Company amended its \$1 billion unsecured revolving credit facility expiring in August 2012 (the "5-Year Facility"), amended its \$750 million term loan maturing in August 2012 ("Term Loan") and canceled its \$300 million, 364-day unsecured revolving credit facility. The amendment to the 5-Year Facility and the Term Loan includes changes to both the fixed charge coverage and leverage covenants. Under the amended covenants, the Company is required to maintain the fixed charge coverage ratio at 1.60 or above through fiscal year 2010 and 1.75 or above thereafter. The leverage ratio, which is debt compared to EBITDA, as those terms are defined in the agreement, must not exceed 5.0 through the third quarter of fiscal year 2010, 4.5 from the fourth quarter of fiscal year 2010 through the third quarter of fiscal year 2011 and 4.0 thereafter. The amendment also increases the interest costs and fees associated with the 5-Year Facility and the Term Loan, provides for certain security interests as defined in the agreement and limits dividends, share repurchases and other restricted payments as defined in the agreement to \$220 million per year with certain potential increases as defined in the agreement. The interest rate as of January 31, 2009 on the Term Loan would have been 6.69% had the amendment been effective at that date. The amendment does not impact the maturity dates of either the 5-Year Facility or the Term Loan. The Company is currently evaluating the impact of the

amendment in accordance with Emerging Issues Task Force (EITF) Issue 96-19, *Debtor's Accounting for a Modification or Exchange of Debt Instruments*, and EITF Issue 98-14, *Debtor's Accounting for Changes in Line-of-Credit or Revolving-Debt Arrangements*.

### 23. Quarterly Financial Data (Unaudited)

The following table provides summarized quarterly financial data for 2008:

|   | Fiscal Quarter Ended                |                       |                     |                         |
|---|-------------------------------------|-----------------------|---------------------|-------------------------|
|   | May 3,<br>2008 (b)                  | August 2,<br>2008 (c) | November 1,<br>2008 | January 31,<br>2009 (d) |
|   | (in millions except per share data) |                       |                     |                         |
| Net Sales   | \$ 1,925                            | \$ 2,284              | \$ 1,843            | \$ 2,991                |
| Gross Profit  | 641                                 | 761                   | 580                 | 1,024                   |
| Operating Income  | 209                                 | 186                   | 41                  | 153                     |
| Income Before Income Taxes  | 176                                 | 164                   | 3                   | 110                     |
| Net Income Attributable to Limited Brands, Inc.                       | 98                                  | 102                   | 4                   | 16                      |
| Net Income Attributable to Limited Brands, Inc. Per Basic Share (a)   | \$ 0.29                             | \$ 0.30               | \$ 0.01             | \$ 0.05                 |
| Net Income Attributable to Limited Brands, Inc. Per Diluted Share (a) | \$ 0.28                             | \$ 0.30               | \$ 0.01             | \$ 0.05                 |

- (a) Due to changes in stock prices during the year and timing of issuances and repurchases of shares, the cumulative total of quarterly net income attributable to Limited Brands, Inc. per share amounts may not equal the per share amount for the year.
- (b) Includes the effect of the following items:
- (i) A pre-tax gain of \$128 million related to the divestiture of a personal care joint venture.
  - (ii) A pre-tax loss of \$19 million related to an impairment charge of an unconsolidated joint venture.
- (c) Includes the effect of a pre-tax gain of \$13 million related to the \$71 million distribution from Express.
- (d) Includes the effect of the following items:
- (i) \$215 million impairment charge of goodwill and other intangible assets for the La Senza business.
  - (ii) \$23 million related to restructuring activities.
  - (iii) A tax benefit of \$15 million related to certain discrete foreign and state income tax items.

The following table provides summarized quarterly financial data for 2007:

|   | Fiscal Quarter Ended                |                       |                         |                         |
|---|-------------------------------------|-----------------------|-------------------------|-------------------------|
|   | May 5,<br>2007                      | August 4,<br>2007 (b) | November 3,<br>2007 (c) | February 2,<br>2008 (d) |
|   | (in millions except per share data) |                       |                         |                         |
| Net Sales   | \$2,311                             | \$ 2,624              | \$ 1,923                | \$ 3,276                |
| Gross Profit (e)  | 794                                 | 811                   | 608                     | 1,296                   |
| Operating Income  | 108                                 | 319                   | 62                      | 621                     |
| Income Before Income Taxes  | 92                                  | 423                   | 23                      | 591                     |
| Net Income Attributable to Limited Brands, Inc.                       | 53                                  | 264                   | 12                      | 389                     |
| Net Income Attributable to Limited Brands, Inc. Per Basic Share (a)   | \$ 0.13                             | \$ 0.68               | \$ 0.03                 | \$ 1.11                 |
| Net Income Attributable to Limited Brands, Inc. Per Diluted Share (a) | \$ 0.13                             | \$ 0.67               | \$ 0.03                 | \$ 1.10                 |

- (a) Due to changes in stock prices during the year and timing of issuances and repurchases of shares, the cumulative total of quarterly net income attributable to Limited Brands, Inc. per share amounts may not equal the per share amount for the year.
- (b) Includes the effect of the following items:
- (i) A pre-tax gain of \$302 million related to the divestiture of a 75% ownership interest in Express.
  - (ii) A pre-tax loss of \$72 million related to the divestiture of a 75% ownership interest in Limited Stores.
  - (iii) A tax benefit of \$39 million related to the reversal of state net operating loss carryforward valuation allowances associated with the Apparel divestitures.
  - (iv) A pre-tax gain of \$100 million related to a distribution from Easton Town Center, LLC.
  - (v) \$47 million of expense related to various restructuring activities.
  - (vi) A pre-tax gain of \$17 million related to an interest rate hedge.
- (c) Includes the effect of a pre-tax gain of \$25 million related to the sale of assets.
- (d) Includes the effect of the following items:
- (i) A pre-tax gain of \$48 million related to initial recognition of income for unredeemed gift cards at Victoria's Secret.
  - (ii) A tax benefit of \$28 million related to a decline in the Canadian federal tax rate, favorable tax benefits associated with the Apparel divestitures, audit settlements and other items.
- (e) Amounts presented are restated for 2007 to conform to current period presentation.

**Limited Brands, Inc.**  
**Computation of Ratio of Earnings to Fixed Charges**

|   | Fiscal Year Ended   |                     |                                      |                     |                     |
|---|---------------------|---------------------|--------------------------------------|---------------------|---------------------|
|   | January 31,<br>2009 | February 2,<br>2008 | February 3,<br>2007<br>(in millions) | January 28,<br>2006 | January 29,<br>2005 |
| <b>Earnings:</b>  |                     |                     |                                      |                     |                     |
| Net Income before income taxes and cumulative effect of change in accounting principle    | \$ 449              | \$ 1,107            | \$ 1,096                             | \$ 958              | \$ 1,116            |
| Fixed charges (excluding capitalized interest)  | 297                 | 268                 | 230                                  | 247                 | 225                 |
| Distributions from equity method investments, net of income or loss from equity investees | 102                 | (3)                 | 6                                    | 26                  | 11                  |
| <b>Total earnings</b>   | <u>\$ 848</u>       | <u>\$ 1,372</u>     | <u>\$ 1,332</u>                      | <u>\$ 1,231</u>     | <u>\$ 1,352</u>     |
| <b>Fixed charges:</b>   |                     |                     |                                      |                     |                     |
| Portion of minimum rent representative of interest  | \$ 115              | \$ 117              | \$ 128                               | \$ 153              | \$ 167              |
| Interest on indebtedness (including capitalized interest)                                 | 184                 | 156                 | 106                                  | 94                  | 58                  |
| <b>Total fixed charges</b>  | <u>\$ 299</u>       | <u>\$ 273</u>       | <u>\$ 234</u>                        | <u>\$ 247</u>       | <u>\$ 225</u>       |
| <b>Ratio of earnings to fixed charges</b>   | 2.8                 | 5.0                 | 5.7                                  | 5.0                 | 6.0                 |

For the purpose of calculating the ratios of earnings to fixed charges, we calculate earnings by adding fixed charges and distributions from equity method investees, net of income or losses from equity method investees, to our pre-tax income from continuing operations before cumulative effect of changes in accounting principle. Fixed charges include total interest and a portion of rent expense, which we believe is representative of the interest factor of our rent expense. Interest associated with income tax liabilities is excluded from our calculation.