DOLLAR GENERAL CORP
Form 10-K
March 22, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended January 28, 2011

Commission file number: 001-11421

DOLLAR GENERAL CORPORATION
(*Exact name of registrant as specified in its charter*)

TENNESSEE
(State or other jurisdiction of incorporation or organization)

61-0502302
(I.R.S. Employer Identification No.)

100 MISSION RIDGE
GOODLETTSVILLE, TN 37072
(Address of principal executive offices, zip code)

Registrant s telephone number, including area code: (615) 855-4000

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of the exchange on which registered**
Common Stock, par value $0.875 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes [X] No [ ]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes [ ] No [X]

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [ ] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer [X]

Accelerated filer [ ]

Non-accelerated filer [ ]

Smaller reporting company [ ]

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

The aggregate fair market value of the registrant s common stock outstanding and held by non-affiliates as of July 30, 2010 was $2,057,296,011 calculated using the closing market price of our common stock as reported on the NYSE on such date ($29.18). For this purpose, directors, executive officers and greater than 10% record shareholders are considered the affiliates of the registrant.

The registrant had 341,521,858 shares of common stock outstanding as of March 16, 2011.

DOCUMENTS INCORPORATED BY REFERENCE

Certain of the information required in Part III of this Form 10-K is incorporated by reference to the Registrant s definitive proxy statement to be filed for the Annual Meeting of Shareholders to be held on May 25, 2011.

INTRODUCTION

General

This report contains references to years 2011, 2010, 2009, 2008, 2007 and 2006, which represent fiscal years ending or ended February 3, 2012, January 28, 2011, January 29, 2010, January 30, 2009, February 1, 2008 and February 2, 2007, respectively. All of the discussion and analysis in this report should be read with, and is qualified in its entirety by, the Consolidated Financial Statements and related notes.

Solely for convenience, our trademarks and tradenames referred to in this document may appear without the ® or ™ symbol, but such references are not intended to indicate, in any way, that we will not assert, to the fullest extent under applicable law, our rights or the right to these trademarks and tradenames.

Cautionary Disclosure Regarding Forward-Looking Statements

We include forward-looking statements within the meaning of the federal securities laws throughout this report, particularly under the headings Business, Management s Discussion and Analysis of Financial Condition and Results of Operations, and Note 9 Commitments and Contingencies, among others. You can identify these statements because they are not limited to historical fact or they use words such as may, will, should, could, believe, anticipate, plan, expect, estimate, objective, forecast, goal, potential, opportunity, intend, will likely result, o similar expressions that concern our strategy, plans, intentions or beliefs about future occurrences or results. For example, all statements relating to our estimated and projected expenditures, cash flows, results of operations, financial condition and liquidity; our plans, objectives and expectations for future operations, growth or initiatives; or the expected outcome or effect of pending or threatened litigation or audits are forward-looking statements.

All forward-looking statements are subject to risks and uncertainties that may change at any time, so our actual results may differ materially from those that we expected. We derive many of these statements from our operating budgets and forecasts, which are based on many detailed assumptions that we believe are reasonable. However, it is very difficult to predict the effect of known factors, and we cannot anticipate all factors that could affect our actual results.

Important factors that could cause actual results to differ materially from the expectations expressed in our forward-looking statements are disclosed under Risk Factors in Part I, Item 1A and elsewhere in this document (including, without limitation, in conjunction with the forward-looking statements themselves and under the heading Critical Accounting Policies and Estimates). All written and oral forward-looking statements are expressly qualified in their entirety by these and other cautionary statements that we make from time to time in our other SEC filings and public communications. You should evaluate forward-looking statements in the context of these risks and uncertainties. These factors may not contain all of the factors that are important to you. We cannot assure you that we will realize the results or developments we

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anticipate or, even if substantially realized, that they will result in the consequences or affect us or our operations in the way we expect.

The forward-looking statements included in this report are made only as of the date hereof. We undertake no obligation to publicly update or revise any forward-looking statement as a result of new information, future events or otherwise, except as otherwise required by law.

PART I

ITEM 1.

BUSINESS

General

We are the largest discount retailer in the United States by number of stores, with 9,414 stores located in 35 states as of February 25, 2011, primarily in the southern, southwestern, midwestern and eastern United States. We offer a broad selection of merchandise, including consumables, seasonal, home products and apparel. Our merchandise includes high quality national brands from leading manufacturers, as well as comparable quality private brand selections with prices at substantial discounts to national brands. We offer our merchandise at everyday low prices (typically $10 or less) through our convenient small-box (approximately 7,200 square feet) locations.

Our History

J.L. Turner founded our Company in 1939 as J.L. Turner and Son, Wholesale. We were incorporated as a Kentucky corporation under the name J.L. Turner & Son, Inc. in 1955, when we opened our first Dollar General store. We changed our name to Dollar General Corporation in 1968 and reincorporated in 1998 as a Tennessee corporation. Our common stock was publicly traded from 1968 until July 2007, when we merged with an entity controlled by investment funds affiliated with Kohlberg Kravis Roberts & Co. L.P., or KKR. On November 13, 2009 our common stock again became publicly traded upon our completion of an initial public offering of 39,215,000 shares of our common stock, including 22,700,000 newly issued shares. We are majority owned by Buck Holdings, L.P., a Delaware limited partnership controlled by KKR, which beneficially owns approximately 71% of our outstanding common stock.

Our Business Model

Our long history of profitable growth is founded on a commitment to a relatively simple business model: providing a broad base of customers with their basic everyday and household needs, supplemented with a variety of general merchandise items, at everyday low prices in conveniently located, small-box stores.

Fiscal year 2010 represented our 21st consecutive year of same-store sales growth. This growth, regardless of economic conditions, suggests that we have a less cyclical model than most retailers and, we believe, is a result of our compelling value and convenience proposition. Both customer traffic and average transaction amount increased during 2009 and 2010 despite a very difficult economic environment. We believe that our customers recognize our efforts to provide them with a pleasant, efficient shopping experience along with our ongoing commitment to meet their everyday needs, which encourages them to continue to shop with us in the future.

Our attractive store economics, including a relatively low initial investment and simple, low cost operating model, have allowed us to grow our store base to over 9,400 stores in 35 states, and provide us significant opportunities to continue our strategy of profitable store growth.

Compelling Value and Convenience Proposition. Our ability to deliver highly competitive prices on national brand and quality private brand products in convenient locations and our easy in and out shopping format create a compelling shopping experience that distinguishes us from other discount, convenience and drugstore retailers. Our slogan, Save time. Save money. Every day! summarizes our appeal to customers. We believe our ability to effectively deliver both value and convenience allows us to succeed in small markets with limited shopping alternatives, as well as to profitably coexist alongside larger retailers in more competitive markets. Our compelling value and convenience proposition is evidenced by the following attributes of our business model:

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Convenient Locations. Our stores are conveniently located in a variety of rural, suburban and urban communities, currently with nearly 70% serving communities with populations of less than 20,000. In more densely populated areas, our small-box stores typically serve the closely surrounding neighborhoods. The majority of our customers live within three to five miles, or a 10-minute drive, of our stores. Our close proximity to customers drives customer loyalty and trip frequency and makes us an attractive alternative to large discount and other large-box retail and grocery stores which are often located farther away. Our low cost economic model enables us to serve many areas with fewer than 1,500 households.

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Time-Saving Shopping Experience. We also provide customers with a highly convenient shopping experience. Our stores smaller size allows us to locate parking near the front entrance where shopping carts are located to promote efficient navigation of the store. Our product offering includes most necessities, such as basic packaged and refrigerated food and dairy products, cleaning supplies, paper products, and health and beauty care items, as well as greeting cards, party supplies, apparel, housewares, hardware and automotive supplies, among others. Our typical store hours are 8:00 a.m. to 9:00 p.m., seven days per week. Our convenient hours and broad merchandise offering allow our customers to fulfill their routine shopping requirements and minimize their need to shop elsewhere.

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Everyday Low Prices on Quality Merchandise. Our research indicates that we offer a price advantage over most food and drug retailers and that our prices are highly competitive with even the largest discount retailers. Our ability to offer everyday low prices on quality merchandise is supported by our low-cost operating structure and our strategy to maintain a limited number of stock keeping units (SKUs) per category, which we believe helps us maintain strong purchasing power. Most items are priced below $10, with approximately 24% at $1 or less. We offer quality nationally advertised brands at these everyday low prices in addition to offering our own comparable quality private brands at value prices.

Attractive Store Economics. The traditional Dollar General store size, design and location requires minimal initial investment and low maintenance capital expenditures. Our typical locations involve a modest, no-frills building, which helps keep our rental and other fixed overhead costs relatively low. When coupled with our new stores ability to generally deliver positive cash flow in the first year, this low capital expenditure requirement typically results in pay back of capital in less than two years. Our stringent market analysis, real estate site selection and new store approval processes as well as our new store marketing programs help us optimize financial returns and minimize the risks of opening unprofitable stores.

Our lean store staffing model and centralized management of utilities, maintenance and supplies procurement contribute to our relatively low operating costs and efficient store operations.

Substantial Growth Opportunities. We believe that we have substantial growth opportunities through both improved profitability of existing stores and new store openings. We are pursuing a number of initiatives which we expect to continue to improve the profitability of our existing store base. In addition, we have identified significant opportunities to add new stores in both existing and new markets. We believe we have the long-term potential in the U.S. to more than double our existing store base while maintaining strong returns on capital. See Our Growth Strategy for additional details.

Our Growth Strategy

We believe we have the right strategy and execution capabilities to capitalize on the considerable growth opportunities afforded by our business model. We believe we continue to have significant opportunities to drive profitable growth through increasing same-store sales, expanding our operating profit rate and growing our store base.

Increasing Same-Store Sales. We believe the combination of our necessity-driven product mix and our attractive value proposition, including a well-balanced merchandising approach, provides a strong basis for increased sales. Our average sales per square foot increased to $201 in 2010 from $195 in 2009 and $180 in 2008. We believe we will continue to have additional opportunities to increase our store productivity through improved in-stock positions, price optimization, continued improvements in space utilization, and additional operating and merchandising initiatives. Among numerous additional projects in 2011, we plan to further expand our frozen and refrigerated food and health and beauty aids offerings. We will also continue to focus on increasing sales in our home, apparel and seasonal categories.

In addition, we plan to relocate or remodel approximately 550 stores in 2011, which we expect to further drive same-store sales growth. In 2010, we remodeled or relocated 504 stores. Remodels and relocations generally consist of updating the stores to our new customer centric format, which we believe appeals to a broader customer base. A relocation typically results in an improved, more visible and accessible location, and usually includes increased square footage. We continue to have opportunities for additional remodels and relocations beyond 2011.

Expanding Operating Profit Rate. Another key component of our growth strategy is improving our operating profit rate through enhanced gross profit and expense reduction initiatives. Our financial results during 2010 and 2009 reflect the favorable impact of our strong category management processes on gross margin improvement and our continued efforts to reduce selling, general and administrative expenses as a percent of sales.

In recent months, we have begun to see many of our product categories impacted by increased costs of commodities, including cotton, wheat, corn, sugar, coffee and resin, as well as increased transportation fuel costs, which have increased significantly in early 2011. These increases pose a challenge to our continued priority of improving our gross profit rate. However, we believe we have options available to mitigate the impact of these increases, including our price optimization, changes to our product selection, such as alternate national brands and the expansion of our private brands, and modifications to our packaging and product size, including items in our planned expansion of merchandise selections priced at $1.00. In addition, we continue to focus on reducing inventory shrinkage and improving distribution efficiencies.

We intend to continue to drive our private brand penetration going forward. Our private brand program complements our model of offering customers nationally branded consumables merchandise at everyday low prices. Generally, private brand items have higher gross profit margins than similar national brand items, and in 2010 represented approximately 22% of our consumables sales. In 2010, we made significant progress in expanding our private brand efforts to our non-consumable offerings, dramatically improving the visual impact of our many non-consumables, including housewares, domestics, lawn and garden tools and summer toys.

We believe we have the potential to directly source a larger portion of our products at significant savings to current costs. In 2010, we imported approximately $750 million of goods, or 8% of total purchases, at cost.

We continually look for ways to improve our cost structure and enhance efficiencies throughout the organization. In 2010, we centralized our procurement system which we expect to aid us in reducing the cost of purchases throughout the company in 2011 and beyond. In addition, we have begun to implement a store labor management and work simplification program, and we are continuing our store rent reduction initiative.

Growing Our Store Base. Based on a detailed, market-by-market analysis, we believe we have the potential to at least double our current number of stores through expansion in both existing and new markets. In 2011, we plan to enter three new states, Connecticut, New Hampshire and Nevada. We have confidence in our real estate disciplines and in our ability to identify, open and operate successful new stores. As a result, we believe that at least our present level of new store growth is sustainable for the foreseeable future. In addition, we continue to believe that in the current real estate market environment there may be opportunities to negotiate lower rent than would have previously been available, allowing us to continue to improve the overall quality of our sites at attractive rental rates.

Our Merchandise

We offer a focused assortment of everyday necessities, which drive frequent customer visits, and key items in a broad range of general merchandise categories. Our product assortment provides the opportunity for our customers to address most of their basic shopping needs with one trip. We sell high quality national brands from leading manufacturers such as Procter & Gamble, Kimberly Clark, Unilever, Kellogg s, General Mills, Nabisco, Coca-Cola and PepsiCo, which are typically found at higher retail prices elsewhere. Additionally, our private brand selections offer consumers even greater value with options to purchase value items and national brand equivalent products at substantial discounts to the national brand.

Our stores generally offer approximately 10,000 total SKUs per store. The number of SKUs in a given store can vary based upon the store s size, geographic location, merchandising initiatives, seasonality, and other factors. Most of our products are priced at $10 or less, with approximately 24% at $1 or less. We separate our merchandise into four categories: 1) consumables; 2) seasonal; 3) home products; and 4) apparel.

Consumables is our largest category and includes paper and cleaning products (such as paper towels, bath tissue, paper dinnerware, trash and storage bags, laundry and other home cleaning supplies); food, including packaged food and perishables (such as cereals, canned soups and vegetables, sugar, flour, milk, eggs and bread); beverages and snacks (including candy, cookies, crackers, salty snacks and carbonated beverages); health and beauty (including over-the-counter medicines and personal care products, such as soap, body wash, shampoo, dental hygiene and foot care products); and pet (including pet supplies and pet food).

Seasonal products include decorations, toys, batteries, small electronics, greeting cards, stationery, prepaid cell phones and accessories, gardening supplies, hardware, automotive and home office supplies.

Home products includes kitchen supplies, cookware, small appliances, light bulbs, storage containers, frames, candles, craft supplies and kitchen, bed and bath soft goods.

Apparel includes casual everyday apparel for infants, toddlers, girls, boys, women and men, as well as socks, underwear, disposable diapers, shoes and accessories.

The percentage of net sales of each of our four categories of merchandise for the fiscal years indicated below was as follows:

	2010	2009	2008
Consumables	71.6 %	70.8 %	

	69.3	%
Seasonal	14.5	%
	14.5	%
	14.6	%
Home products	7.0	%
	7.4	%
	8.2	%
Apparel	6.9	%
	7.3	

%

7.9

%

Our home products and seasonal categories typically account for the highest gross profit margins, and the consumables category typically accounts for the lowest gross profit margin.

The Dollar General Store

The average Dollar General store has approximately 7,200 square feet of selling space and is typically operated by a manager, an assistant manager and three or more sales clerks. Approximately 58% of our stores are in freestanding buildings, 41% in strip shopping centers and 1% are in downtown buildings. Most of our customers live within three to five miles, or a 10 minute drive, of our stores. Our store strategy features low initial capital expenditures, limited maintenance capital, low occupancy and operating costs, and a focused merchandise offering within a broad range of categories, allowing us to deliver low retail prices while generating strong cash flows and investment returns. In 2010, the average cost of equipment and fixtures in our leased stores was approximately $165,000. Initial inventory, net of payables, increases the investment in a new store by approximately $75,000.

We generally have not encountered difficulty locating suitable store sites in the past. Given the size of the communities that we target, we believe that there is ample opportunity for new store growth in existing and new markets. In addition, the current real estate market is providing an opportunity for us to access higher quality sites at lower rates than in recent years. Also, we believe we have significant opportunities available for our relocation and remodel programs. We spend approximately $75,000 for equipment and fixtures to remodel a store and approximately $140,000 to relocate one. We remodeled or relocated 504 stores in 2010, 450 in 2009 and 404 in 2008.

Our recent store growth is summarized in the following table:

Year	**Stores at Beginning of Year**	**Stores Opened**	**Stores Closed**	**Net Store Increase/(Decrease)**	**Stores at End of Year**
2008	8,194	207	39	168	8,362
2009	8,362	500	34		

466

8,828

2010

8,828

600

56

544

9,372

Our Customers

Our customers seek value and convenience. Depending on their financial situation and geographic proximity, customers reliance on Dollar General varies from fill-in shopping to periodic routine trips in order to stock up on household items, to weekly or more frequent trips to meet most essential needs. We believe that our value and convenience proposition attracts customers from a wide range of income brackets and life stages. In the last year, we have seen increases in the annual number of shopping trips that our customers make to Dollar General as well as the amount spent during each trip.

We continue to focus on the quality, selection and pricing of our merchandise, targeted advertising, improved store standards and site selection processes, among other initiatives, to attract new and retain existing customers.

Our Suppliers

We purchase merchandise from a wide variety of suppliers and maintain direct buying relationships with many producers of national brand merchandise, such as Procter & Gamble, Kimberly Clark, Unilever, Kellogg s, General Mills, Nabisco, Coca-Cola and PepsiCo. Despite our broad offering, we maintain only a limited number of SKUs per category, giving us a pricing advantage in dealing with our suppliers. Approximately 9% and 7% of our purchases in 2010 were from our largest and second largest suppliers, respectively. Our private brands come from a diversified supplier base. We directly imported approximately 8% of our purchases at cost (13% of our purchases at retail) in 2010. Our vendor arrangements generally provide for payment for such merchandise in U.S. dollars.

We have not experienced any difficulty in obtaining sufficient quantities of core merchandise and believe that, if one or more of our current sources of supply became unavailable, we would generally be able to obtain alternative sources without experiencing a substantial disruption of our business. However, such alternative sources could increase our merchandise costs or reduce the quality of our merchandise, and an inability to obtain alternative sources could adversely affect our sales.

Distribution, Transportation and Inventory Management

Our stores are supported by nine distribution centers located strategically throughout our geographic footprint. Of these nine, we own six and lease the other three. We lease additional temporary warehouse space as necessary to support our distribution needs. To support our growth, we are in the process of constructing our tenth distribution center near Birmingham, Alabama. We expect this new distribution center to be operational in 2012. Over the past few years we have made significant investments in facilities, technological improvements and upgrades, and we continue to improve work processes, all of which increase our efficiency and ability to support our merchandising and operations initiatives as well as our new store growth. We continually analyze and rebalance the network to ensure that it remains efficient and provides the service our stores require. See Properties for additional information pertaining to our distribution centers.

Most of our merchandise flows through our distributions centers and is delivered to our stores by third-party trucking firms, utilizing our trailers. Our agreements with these trucking firms are based on estimated costs of diesel fuel, with the difference in estimated and current market fuel costs passed through to us. The costs of diesel fuel are significantly influenced by international, political and economic circumstances, and have risen in recent months, including considerable increases in early 2011. If such increased prices remain in effect, or if further price increases were to arise for any reason, including fuel supply shortages or unusual price volatility, the resulting higher fuel prices could materially increase our transportation costs.

In addition, we believe that there remains opportunity to improve our inventory turns. Initiatives in process include operational efforts to optimize presentation levels and decrease excess quantities shipped to our stores. We continue to focus on SKU optimization in an attempt to ensure that we can meet our customers demands for our most popular products as well as for product assortment. We are also in the early stages of implementing an improved supply chain solution to assist in ordering, monitoring and tracking inventory from purchase order to receipt to maintain efficient levels of inventory. We turned our inventory approximately 5.2 times over the most recent four quarters.

Seasonality

Our business is seasonal to a certain extent. Generally, our highest sales volume occurs in the fourth quarter, which includes the Christmas selling season, and the lowest occurs in the first quarter. In addition, our quarterly results can be affected by the timing of new store openings and store closings, the amount of sales contributed by new and existing stores, as well as the timing of certain holidays. We purchase substantial amounts of inventory in the third quarter and incur higher shipping costs and higher payroll costs in anticipation of the increased sales activity during the fourth quarter. In addition, we carry merchandise during our fourth quarter that we do not carry during the rest of the year, such as gift sets, holiday decorations, certain baking items, and a broader assortment of toys and candy.

The following table reflects the seasonality of net sales, gross profit, and net income (loss) by quarter for each of the quarters of our three most recent fiscal years. All of the quarters reflected below are comprised of 13 weeks.

(in millions)	**1st Quarter**	**2nd Quarter**	**3rd Quarter**	**4th Quarter**
Year Ended January 28, 2011				

Net sales	$ 3,111.3	$ 3,214.2	$ 3,223.4	$ 3,486.1
Gross profit	999.8	1,036.0	1,010.7	1,130.2
Net income	136.0			

141.2

128.1

222.5

Year Ended January 29, 2010

Net sales

	$ 2,779.9
	$ 2,901.9
	$ 2,928.8
	$ 3,185.8
Gross profit	
	855.4
	906.0
	903.1
	1,025.4
Net income (a)	
	83.0
	93.6
	75.6

87.2

Year Ended January 30, 2009

Net sales	$ 2,403.5	$ 2,609.4

$
2,598.9
$
2,845.8
Gross profit
693.1
758.0
772.3
837.7
Net income (loss) (b)
5.9
27.7
(7.3)
81.9

(a)

Includes expenses, net of income taxes, of $82.9 million related to our initial public offering during the fourth quarter of 2009.

(b)

Includes expenses, net of income taxes, of $37.4 million related to the settlement of a shareholder lawsuit during the third quarter of 2008.

Our Competition

We operate in the basic discount consumer goods market, which is highly competitive with respect to price, store location, merchandise quality, assortment and presentation, in-stock consistency, and customer service. We compete with discount stores and with many other retailers, including mass merchandise, grocery, drug, convenience, variety and other specialty stores. These other retail companies operate stores in many of the areas where we operate, and many of them engage in extensive advertising and marketing efforts. Our direct competitors include Family Dollar, Dollar Tree, Fred s, 99 Cents Only and various local, independent operators, as well as Walmart, Walgreens, CVS, Rite Aid, Target and Costco, among others. Certain of our competitors have greater financial, distribution, marketing and other resources than we do.

We differentiate ourselves from other forms of retailing by offering consistently low prices in a convenient, small-store format. We believe that our prices are competitive due in part to our low cost operating structure and the relatively limited assortment of products offered. Historically, we have minimized labor by offering fewer price points and a reliance on simple merchandise presentation. Purchasing large volumes of merchandise within our focused assortment in each merchandise category allows us to keep our average costs low, contributing to our ability to offer competitive everyday low prices to our customers. See Our Business Model above for further discussion of our competitive situation.

Our Employees

As of February 25, 2011, we employed approximately 85,900 full-time and part-time employees, including divisional and regional managers, district managers, store managers, other store personnel and distribution center and administrative personnel. We have increasingly focused on recruiting, training, motivating and retaining employees, and we believe that the quality, performance and morale of our employees have increased as a result. We currently are not a party to any collective bargaining agreements.

Our Trademarks

We own marks that are registered with the United States Patent and Trademark Office and are protected under applicable intellectual property laws, including without limitation the trademarks Dollar General®, Dollar General Market®, Clover Valley®, DG®, DG Guarantee®, Smart & Simple®, trueliving®, Sweet Smiles® and the Dollar General price point designs, along with variations and formatives of these trademarks as well as certain other trademarks. We attempt to obtain registration of our trademarks whenever practicable and to pursue vigorously any infringement of those marks. Our trademark registrations have various expiration dates; however, assuming that the trademark registrations are properly renewed, they have a perpetual duration.

We also hold licenses to use various trademarks owned by third parties, including an exclusive license to the Bobbie Brooks brand for clothing through March 31, 2011, with the option to renew such license on a year-to-year basis, a license to the Fisher Price brand for certain items of children s clothing through December 31, 2013, and an exclusive license to the Rexall brand through March 5, 2020.

Available Information

Our Web site address is www.dollargeneral.com. We file with or furnish to the Securities and Exchange Commission (the SEC) annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports, proxy statements and annual reports to shareholders, and, from time to time, registration statements and other documents. These documents are available free of charge to investors on or through the Investor Information portion of our Web site as soon as reasonably practicable after we electronically file them with or furnish them to the SEC. In addition, the public may read and copy any of the materials we file with the SEC at the SEC s Public Reference Room at 100 F Street, NE, Washington DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet site that contains reports, proxy and information statements and other information regarding issuers, such as Dollar General, that file electronically with the SEC. The address of that Web site is http://www.sec.gov.

ITEM 1A.

RISK FACTORS

You should carefully consider the risks described below and the other information contained in this report and other filings that we make from time to time with the SEC, including our consolidated financial statements and accompanying notes. Any of the following risks could materially and adversely affect our business, financial condition, results of operations or liquidity. In addition, the risks described below are not the only risks we face. Our business, financial condition, results of operations or liquidity could also be adversely affected by additional factors that apply to all companies generally, as well as other risks that are not currently known to us or that we currently view to be immaterial. While we attempt to mitigate known risks to the extent we believe to be practicable and reasonable, we can provide no assurance, and we make no representation, that our mitigation efforts will be successful.

Current economic conditions and other economic factors may adversely affect our financial performance and other aspects of our business.

We believe that many of our customers are on fixed or low incomes and generally have limited discretionary spending dollars. A further slowdown in the economy, or a delayed recovery, or other economic conditions affecting disposable consumer income, such as increased unemployment or underemployment levels, inflation, increases in fuel or other energy costs and interest rates, lack of available credit, consumer debt levels, higher tax rates and other changes in tax laws, and further erosion in consumer confidence, may adversely affect our business by reducing our customers spending or by causing them to shift their spending to products other than those sold by us or to products sold by us that are less profitable than other product choices, all of which could result in lower net sales, decreases in inventory turnover, greater markdowns on inventory, and a reduction in profitability due to lower margins. Many of those factors, as well as commodity rates, transportation costs (including the costs of diesel fuel), costs of labor, insurance and healthcare, foreign exchange rate fluctuations, lease costs, measures that create barriers to or increase the costs associated with international trade, changes in other laws and regulations and other economic factors, also affect our cost of goods sold and our selling, general and administrative expenses, which may adversely affect our sales or profitability. We have limited or no ability to control many of these factors. We saw product costs begin to escalate in our 2010 fourth quarter as a result of increases in the costs of certain commodities (including cotton, wheat, corn, sugar, coffee, resin), and increasing diesel fuel costs. We will be diligent in our efforts to keep product costs as low as possible in the face of these increases while still working to optimize gross profit and meet the needs of our customers.

In addition, many of the factors discussed above, along with current global economic conditions and uncertainties, the potential for additional failures or realignments of financial institutions, and the related impact on available credit may affect us and our suppliers and other business partners, landlords and service providers in an adverse manner including, but not limited to, reducing access to liquid funds or credit, increasing the cost of credit, limiting our ability to manage interest rate risk, increasing the risk of bankruptcy of our suppliers, landlords or counterparties to or other financial institutions involved in our credit facilities and our derivative and other contracts, increasing the cost of goods to us, and other adverse consequences which we are unable to fully anticipate or control.

Our plans depend significantly on initiatives designed to increase sales and improve the efficiencies, costs and effectiveness of our operations, and failure to achieve or sustain these plans could affect our performance adversely.

We have initiatives (such as those relating to marketing, merchandising, promotions, sourcing, shrink, private brand, store operations and real estate) in various stages of testing, evaluation, and implementation, upon which we expect to rely to continue to improve our results of operations and financial condition and to achieve our financial plans. These initiatives are inherently risky and uncertain, even when tested successfully, in their application to our business in general. It is possible that successful testing can result partially from resources and attention that cannot be duplicated in broader implementation, particularly in light of the diverse geographic locations of our stores and the fact that our field management is so decentralized. General implementation also may be negatively affected by other risk factors described herein. Successful systemwide implementation relies on consistency of training, stability of workforce, ease of execution, and the absence of offsetting factors that can influence results adversely. Failure to achieve successful implementation of our initiatives or the cost of these initiatives exceeding management s estimates could adversely affect our results of operations and financial condition.

In addition, the success of our merchandising initiatives, particularly those with respect to non-consumable merchandise, depends in part upon our ability to predict consistently and successfully the products our customers will demand and to identify and timely respond to evolving trends in demographics and consumer preferences, expectations and needs. If we are unable to select products that are attractive to customers, to obtain such products at costs that allow us to sell them at a profit, or to effectively market such products, our sales, market share and profitability could be adversely affected. If our merchandising efforts in the non-consumables area are unsuccessful, we could be further adversely affected by our inability to offset the lower margins associated with our consumables business.

We face intense competition that could limit our growth opportunities and adversely impact our financial performance.

The retail business is highly competitive. We operate in the basic discount consumer goods market, which is competitive with respect to price, store location, merchandise quality, assortment and presentation, in-stock consistency, and customer service. This competitive environment subjects us to the risk of adverse impact to our financial performance because of the lower prices, and thus the lower margins, required to maintain our competitive position. Also, companies like ours operating in the basic discount consumer goods market (due to customer demographics and other factors) may have limited ability to increase prices in response to increased costs without losing competitive position. This limitation may adversely affect our margins and financial performance. We compete for customers, employees, store sites, products and services and in other important aspects of our business with many other local, regional and national retailers. We compete with retailers operating discount, mass merchandise, outlet, warehouse club, grocery, drug, convenience, variety and other specialty stores. Certain of our competitors have greater financial, distribution, marketing and other resources than we do and may be able to secure better arrangements with suppliers than we can. These other competitors

compete in a variety of other ways, including aggressive promotional activities, merchandise selection and availability, services offered to customers, location, store hours, in-store amenities and price. If we fail to respond effectively to competitive pressures and changes in the retail markets, it could adversely affect our financial performance.

Competition for customers has intensified in recent years as larger competitors have moved into, or increased their presence in, our geographic markets. In addition, some of our large box competitors are or may be developing small box formats which may produce more competition. We remain vulnerable to the marketing power and high level of consumer recognition of these larger competitors and to the risk that these competitors or others could venture into our industry in a significant way. Generally, we expect an increase in competition.

Our private brands may not achieve or maintain broad market acceptance and increase the risks we face.

We have substantially increased the number of our private brand items, and the program is a sizable part of our future growth plans. We believe that our success in gaining and maintaining broad market acceptance of our private brands depends on many factors, including pricing, our costs, quality and customer perception. We may not achieve or maintain our expected sales for our private brands. As a result, our business, financial condition and results of operations could be materially and adversely affected.

A significant disruption to our distribution network or to the timely receipt of inventory could adversely impact sales or increase our transportation costs, which would decrease our profits.

We rely on our distribution and transportation network to provide goods to our stores in a timely and cost-effective manner through deliveries to our distribution centers from vendors and then from the distribution centers or direct ship vendors to our stores by various means of transportation, including shipments by sea and truck. Any disruption, unanticipated expense or operational failure related to this process could affect store operations negatively. For example, unexpected delivery delays or increases in transportation costs (including through increased fuel costs or a decrease in transportation capacity for overseas shipments) could significantly decrease our ability to make sales and earn profits. In addition, labor shortages or work stoppages in the transportation industry or long-term disruptions to the national and international transportation infrastructure that lead to delays or interruptions of deliveries could negatively affect our business.

We maintain a network of distribution facilities and have plans to build new facilities to support our growth objectives. Delays in opening distribution centers could adversely affect our future operations by slowing store growth, which may in turn reduce revenue growth. In addition, the planned construction of a new distribution center in 2011, and any future distribution-related construction or expansion projects, entail risks which could cause delays and cost overruns, such as: shortages of materials; shortages of skilled labor or work stoppages; unforeseen construction, scheduling, engineering, environmental or geological problems; weather interference; fires or other casualty losses; and unanticipated cost increases. The

completion date and ultimate cost of this or future projects could differ significantly from initial expectations due to construction-related or other reasons. We cannot guarantee that any project will be completed on time or within established budgets.

Rising fuel costs could materially adversely affect our business.

Fuel prices have risen considerably in recent months and are significantly influenced by international, political and economic circumstances. These increases pose a challenge to our continued priority of improving our gross profit rate. If such increased prices remain in effect, or if further price increases were to arise for any reason, including fuel supply shortages or unusual price volatility, the resulting higher fuel prices could materially increase our transportation costs, adversely affecting our gross profit and results of operations. In addition, competitive pressures in our industry may have the effect of inhibiting our ability to reflect these increased costs in the prices of our products. We will be diligent in our efforts to keep product costs as low as possible in the face of these increases while still working to optimize gross profit and meet the needs of our customers.

Risks associated with or faced by the domestic and foreign suppliers from whom our products are sourced could adversely affect our financial performance.

The products we sell are sourced from a wide variety of domestic and international suppliers. In fact, our largest supplier accounted for 9% of our purchases in 2010, and our next largest supplier accounted for approximately 7% of such purchases. We have not experienced any difficulty in obtaining sufficient quantities of core merchandise and believe that, if one or more of our current sources of supply became unavailable, we would generally be able to obtain alternative sources without experiencing a substantial disruption of our business. However, such alternative sources could increase our merchandise costs and reduce the quality of our merchandise, and an inability to obtain alternative sources could adversely affect our sales.

We directly imported approximately 8% of our purchases (measured at cost) in 2010, but many of our domestic vendors directly import their products or components of their products. Changes to the prices and flow of these goods for any reason, such as political and economic instability in the countries in which foreign suppliers are located, the financial instability of suppliers, suppliers failure to meet our standards, issues with labor practices of our suppliers or labor problems they may experience (such as strikes), the availability and cost of raw materials to suppliers, merchandise quality or safety issues, currency exchange rates, transport availability and cost, inflation, and other factors relating to the suppliers and the countries in which they are located or from which they import, are beyond our control and could adversely affect our operations and profitability. Because a substantial amount of our imported merchandise comes from China, a change in the Chinese currency or other policies could negatively impact our merchandise costs. In addition, the United States foreign trade policies, tariffs and other impositions on imported goods, trade sanctions imposed on certain countries, the limitation on the importation of certain types of goods or of goods containing certain materials from other countries and other factors relating to foreign trade are beyond our control. Disruptions due to labor stoppages, strikes or slowdowns, or other disruptions involving our vendors or the transportation and handling industries also may negatively affect our ability to receive

merchandise and thus may negatively affect sales. These and other factors affecting our suppliers and our access to products could adversely affect our financial performance. As we increase our imports of merchandise from foreign vendors, the risks associated with foreign imports will increase.

Product liability and food safety claims could adversely affect our business, reputation and financial performance.

Despite our best efforts to ensure the quality and safety of the products we sell, we may be subject to product liability claims from customers or penalties from government agencies relating to products, including food products, that are recalled, defective or otherwise alleged to be harmful. Such claims may result from tampering by unauthorized third parties, product contamination or spoilage, including the presence of foreign objects, substances, chemicals, other agents, or residues introduced during the growing, storage, handling and transportation phases. All of our vendors and their products must comply with applicable product and food safety laws. We generally seek contractual indemnification and insurance coverage from our suppliers. However, if we do not have adequate contractual indemnification and/or insurance available, such claims could have a material adverse effect on our business, financial condition and results of operations. Our ability to obtain indemnification from foreign suppliers may be hindered by the manufacturers lack of understanding of U.S. product liability or other laws, which may make it more likely that we be required to respond to claims or complaints from customers as if we were the manufacturer of the products. Even with adequate insurance and indemnification, such claims could significantly damage our reputation and consumer confidence in our products. Our litigation expenses could increase as well, which also could have a materially negative impact on our results of operations even if a product liability claim is unsuccessful or is not fully pursued.

We are subject to governmental regulations, procedures and requirements. A significant change in, or noncompliance with, these regulations could have a material adverse effect on our financial performance.

Our business is subject to numerous federal, state and local laws and regulations. We routinely incur costs in complying with these regulations. New laws or regulations, particularly those dealing with healthcare reform, product safety, and labor and employment, among others, or changes in existing laws and regulations, particularly those governing the sale of products, may result in significant added expenses or may require extensive system and operating changes that may be difficult to implement and/or could materially increase our cost of doing business. In addition, such changes or new laws may require the write off and disposal of existing product inventory, resulting in significant adverse financial impact to us. Untimely compliance or noncompliance with applicable regulations or untimely or incomplete execution of a required product recall can result in the imposition of penalties, including loss of licenses or significant fines or monetary penalties, in addition to reputational damage.

Litigation may adversely affect our business, financial condition and results of operations.

Our business is subject to the risk of litigation by employees, consumers, suppliers, competitors, shareholders, government agencies and others through private actions, class actions, administrative proceedings, regulatory actions or other litigation. The number of employment-related class actions filed each year has continued to increase, and recent changes and proposed changes in Federal and state laws may cause claims to rise even more. The outcome of litigation, particularly class action lawsuits, regulatory actions and intellectual property claims, is difficult to assess or quantify. Plaintiffs in these types of lawsuits may seek recovery of very large or indeterminate amounts, and the magnitude of the potential loss relating to these lawsuits may remain unknown for substantial periods of time. In addition, certain of these lawsuits, if decided adversely to us or settled by us, may result in liability material to our financial statements as a whole or may negatively affect our operating results if changes to our business operation are required. The cost to defend future litigation may be significant. There also may be adverse publicity associated with litigation that could negatively affect customer perception of our business, regardless of whether the allegations are valid or whether we are ultimately found liable. As a result, litigation may adversely affect our business, financial condition and results of operations. See Note 9 to the consolidated financial statements for further details regarding certain of these pending matters.

If we cannot open new stores profitably and on schedule, our planned future growth will be impeded, which would adversely affect sales.

Our ability to open profitable new stores is a key component of our planned future growth. Our ability to timely open such stores and to expand into additional market areas depends in part on the following factors: the availability of attractive store locations; the absence of occupancy delays; the ability to negotiate acceptable lease and development terms; the ability to hire and train new personnel, especially store managers, in a cost effective manner; the ability to identify customer demand in different geographic areas; general economic conditions; and the availability of sufficient funds for expansion. Many of these factors affect our ability to successfully relocate stores, and many of them are beyond our control. In addition, our credit ratings, combined with tighter lending practices, have made financing more challenging for our real estate developers in today s market. These unfavorable lending trends could potentially impact the timing of our store openings and build-to-suit program.

Delays or failures in opening new stores, or achieving lower than expected sales in new stores, or drawing a greater than expected proportion of sales in new stores away from existing stores, could materially adversely affect our growth and/or profitability. In addition, we may not anticipate all of the challenges imposed by the expansion of our operations and, as a result, may not meet our targets for opening new stores, remodeling or relocating stores or expanding profitably.

Some of our new stores may be located in areas where we have little or no meaningful experience or brand recognition. Those markets may have different competitive conditions, market conditions, consumer tastes and discretionary spending patterns than our existing

markets, which may cause our new stores to be less successful than stores in our existing markets.

Many of our new stores will be located in areas where we have existing units. Although we have experience in these markets, increasing the number of locations in these markets may result in inadvertent over-saturation of markets and temporarily or permanently divert customers and sales from our existing stores, thereby adversely affecting our overall financial performance.

Natural disasters (whether or not caused by climate change), unusual weather conditions, pandemic outbreaks, terrorist acts, and global political events could cause permanent or temporary distribution center or store closures, impair our ability to purchase, receive or replenish inventory, or decrease customer traffic, all of which could result in lost sales and otherwise adversely affect our financial performance.

The occurrence of one or more natural disasters, such as hurricanes, fires, floods, and earthquakes (whether or not caused by climate change), unusual weather conditions, pandemic outbreaks, terrorist acts or disruptive global political events, such as civil unrest in countries in which our suppliers are located, or similar disruptions could adversely affect our operations and financial performance. To the extent these events result in the closure of one or more of our distribution centers, a significant number of stores, or our corporate headquarters or impact one or more of our key suppliers, our operations and financial performance could be materially adversely affected through an inability to make deliveries or provide other support functions to our stores and through lost sales. In addition, these events could result in increases in fuel (or other energy) prices or a fuel shortage, delays in opening new stores, the temporary lack of an adequate work force in a market, the temporary or long-term disruption in the supply of products from some domestic and overseas suppliers, the temporary disruption in the transport of goods from overseas, delay in the delivery of goods to our distribution centers or stores, the temporary reduction in the availability of products in our stores and disruption of our utility services or to our information systems. These events also can have indirect consequences such as increases in the costs of insurance if they result in significant loss of property or other insurable damage.

Material damage to, or interruptions to, our information systems as a result of external factors, staffing shortages and difficulties in updating our existing technology or developing or implementing new technology could have a material adverse effect on our business or results of operations.

We depend on a variety of information technology systems for the efficient functioning of our business. Such systems are subject to damage or interruption from power outages, computer and telecommunications failures, computer viruses, security breaches and natural disasters. Damage or interruption to these systems may require a significant investment to fix or replace them, and we may suffer interruptions in our operations in the interim. Any material interruptions may have a material adverse effect on our business or results of operations.

We also rely heavily on our information technology staff. Failure to meet these staffing needs may negatively affect our ability to fulfill our technology initiatives while continuing to provide maintenance on existing systems. We rely on certain vendors to maintain and

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periodically upgrade many of these systems so that they can continue to support our business. The software programs supporting many of our systems were licensed to us by independent software developers. The inability of these developers or us to continue to maintain and upgrade these information systems and software programs would disrupt or reduce the efficiency of our operations if we were unable to convert to alternate systems in an efficient and timely manner. In addition, costs and potential problems and interruptions associated with the implementation of new or upgraded systems and technology, such as the implementation of our new supply chain solution, or with maintenance or adequate support of existing systems could also disrupt or reduce the efficiency of our operations.

Failure to attract and retain qualified employees, particularly field, store and distribution center managers, and to control labor costs, as well as other labor issues, could adversely affect our financial performance.

Our future growth and performance depends on our ability to attract, retain and motivate qualified employees, many of whom are in positions with historically high rates of turnover such as field managers and distribution center managers. Our ability to meet our labor needs, while controlling our labor costs, is subject to many external factors, including competition for and availability of qualified personnel in a given market, unemployment levels within those markets, prevailing wage rates, minimum wage laws, health and other insurance costs, and changes in employment and labor laws (including changes in the process for our employees to join a union) or other workplace regulation (including changes in entitlement programs such as health insurance and paid leave programs). To the extent a significant portion of our employee base unionizes, or attempts to unionize, our labor costs could increase. In addition, we are evaluating the potential future impact of recently enacted comprehensive healthcare reform legislation, which will likely cause our healthcare costs to increase. While the significant costs of the healthcare reform legislation will occur after 2013 due to provisions of the legislation being phased in over time, changes to our healthcare costs structure could have a significant negative effect on our business. Our ability to pass along labor costs to our customers is constrained by our low price model.

Our profitability may be negatively affected by inventory shrinkage.

We are subject to the risk of inventory loss and theft. We experience significant inventory shrinkage, and we cannot assure you that incidences of inventory loss and theft will decrease in the future or that the measures we are taking will effectively address the problem of inventory shrinkage. Although some level of inventory shrinkage is an unavoidable cost of doing business, if we were to experience higher rates of inventory shrinkage or incur increased security costs to combat inventory theft, our financial condition could be affected adversely.

Our cash flows from operations may be negatively affected if we are not successful in managing our inventory balances.

Our inventory balance represented approximately 45% of our total assets exclusive of goodwill and other intangible assets as of January 28, 2011. Efficient inventory management is a key component of our business success and profitability. To be successful, we must maintain sufficient inventory levels to meet our customers demands without allowing those levels to

increase to such an extent that the costs to store and hold the goods unduly impacts our financial results. If our buying decisions do not accurately predict customer trends or purchasing actions, we may have to take unanticipated markdowns to dispose of the excess inventory, which also can adversely impact our financial results. We continue to focus on ways to reduce these risks, but we cannot assure you that we will be successful in our inventory management. If we are not successful in managing our inventory balances, our cash flows from operations may be negatively affected.

Because our business is seasonal to a certain extent, with the highest volume of net sales during the fourth quarter, adverse events during the fourth quarter could materially affect our financial statements as a whole.

We generally recognize our highest volume of net sales during the Christmas selling season, which occurs in the fourth quarter of our fiscal year. In anticipation of this holiday, we purchase substantial amounts of seasonal inventory and hire many temporary employees. An excess of seasonal merchandise inventory could result if our net sales during the Christmas selling season were to fall below either seasonal norms or expectations. If our fourth quarter sales results were substantially below expectations, our financial performance and operating results could be adversely affected by unanticipated markdowns, especially in seasonal merchandise. Lower than anticipated sales in the Christmas selling season would also negatively affect our ability to absorb the increased seasonal labor costs.

Our current insurance program may expose us to unexpected costs and negatively affect our financial performance.

Our insurance coverage reflects deductibles, self-insured retentions, limits of liability and similar provisions that we believe are prudent based on the dispersion of our operations. However, there are types of losses we may incur but against which we cannot be insured or which we believe are not economically reasonable to insure, such as losses due to acts of war, employee and certain other crime and some natural disasters. If we incur these losses and they are material, our business could suffer. Certain material events may result in sizable losses for the insurance industry and adversely impact the availability of adequate insurance coverage or result in excessive premium increases. To offset negative insurance market trends, we may elect to self-insure, accept higher deductibles or reduce the amount of coverage in response to these market changes. In addition, we self-insure a significant portion of expected losses under our workers compensation, automobile liability, general liability and group health insurance programs. Unanticipated changes in any applicable actuarial assumptions and management estimates underlying our recorded liabilities for these losses, including expected increases in medical and indemnity costs, could result in materially different expenses than expected under these programs, which could have a material adverse effect on our financial condition and results of operations. In addition, we are evaluating the potential future impact of recently enacted comprehensive healthcare reform legislation, which may cause our healthcare costs to increase. Although we continue to maintain property insurance for catastrophic events at our store support center and distribution centers, we are effectively self-insured for other property losses. If we experience a greater number of these losses than we anticipate, our financial performance could be adversely affected.

If we fail to protect our brand name, competitors may adopt tradenames that dilute the value of our brand name.

We may be unable or unwilling to strictly enforce our trademarks in each jurisdiction in which we do business. Also, we may not always be able to successfully enforce our trademarks against competitors, or against challenges by others. Our failure to successfully protect our trademarks could diminish the value and efficacy of our brand recognition, and could cause customer confusion, which could, in turn, adversely affect our sales and profitability.

Our success depends on our executive officers and other key personnel. If we lose key personnel or are unable to hire additional qualified personnel, our business may be harmed.

Our future success depends to a significant degree on the skills, experience and efforts of our executive officers and other key personnel. The loss of the services of any of our executive officers, particularly Richard W. Dreiling, our Chief Executive Officer, could have a material adverse effect on our operations. Our future success will also depend on our ability to attract and retain qualified personnel and a failure to attract and retain new qualified personnel could have an adverse effect on our operations. We do not currently maintain key person life insurance policies with respect to our executive officers or key personnel.

We face risks related to protection of customers credit and debt card data and private data relating to us or our customers or employees.

In connection with credit card sales, we transmit confidential credit and debit card information. We also have access to, collect or maintain private or confidential information regarding our customers and employees, as well as our business. We have procedures and technology in place to safeguard our customers debit and credit card information, our employees private data, and our confidential business information. However, third parties may have the technology or know-how to breach the security of this information, and our security measures and those of our technology vendors may not effectively prohibit others from obtaining improper access to this information. A security breach of any kind could expose us to risks of data loss, litigation, government enforcement actions and costly response measures, and could seriously disrupt our operations. Any resulting negative publicity could significantly harm our reputation which could cause us to lose market share and have an adverse effect in our financial results.

While we have reduced our debt levels since 2007, we continue to have substantial debt that will need to be repaid or refinanced at or prior to applicable maturity dates which could adversely affect our ability to raise additional capital to fund our operations and limit our ability to pursue our growth strategy or other opportunities or to react to changes in the economy or our industry.

At January 28, 2011, we had total outstanding debt (including the current portion of long-term obligations) of $3.29 billion, including a $1.964 billion senior secured term loan facility which matures on July 6, 2014, $864.3 million aggregate principal amount of 10.625% senior notes due 2015 and $450.7 million aggregate principal amount of 11.875% / 12.625% senior subordinated toggle notes due 2017. We also had an additional $959.3 million available for borrowing under our senior secured asset-based revolving credit facility of up to $1.031 billion, which matures July 6, 2013. This level of debt and our ability to repay or refinance this debt prior to maturity could have important negative consequences to our business, including:

- increasing our vulnerability to general economic and industry conditions because our debt payment obligations may limit our ability to use our cash to respond to or defend against changes in the industry or the economy;

- requiring a substantial portion of our cash flow from operations to be dedicated to the payment of principal and interest on our indebtedness, therefore reducing our ability to use our cash flow to fund our operations, capital expenditures and future business opportunities or pay dividends;

- limiting our ability to pursue our growth strategy;

- placing us at a disadvantage compared to our competitors who are less highly leveraged and may be better able to use their cash flow to fund competitive responses to changing industry, market or economic conditions;

- limiting our ability to obtain additional financing for working capital, capital expenditures, debt service requirements, acquisitions and general corporate or other purposes; and

- increasing the difficulty of our ability to make payments on our outstanding debt.

Our variable rate debt exposes us to interest rate risk which could adversely affect our cash flow.

The borrowings under the term loan facility and the senior secured asset-based revolving credit facility comprise our credit facilities and bear interest at variable rates. Other debt we incur also could be variable rate debt. If market interest rates increase, variable rate debt will create higher debt service requirements, which could adversely affect our cash flow. While we have entered and may in the future enter into agreements limiting our exposure to higher interest rates, any such agreements may not offer complete protection from this risk.

Our debt agreements contain restrictions that could limit our flexibility in operating our business.

Our credit facilities and the indentures governing our notes contain various covenants that could limit our ability to engage in specified types of transactions. These covenants limit our and our restricted subsidiaries ability to, among other things:

- incur additional indebtedness, issue disqualified stock or issue certain preferred stock;
- pay dividends and make certain distributions, investments and other restricted payments;
- create certain liens or encumbrances;
- sell assets;
- enter into transactions with our affiliates;
- allow payments to us by our restricted subsidiaries;
- merge, consolidate, sell or otherwise dispose of all or substantially all of our assets; and

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designate our subsidiaries as unrestricted subsidiaries.

A breach of any of these covenants could result in a default under the agreement governing such indebtedness. Upon our failure to maintain compliance with these covenants, the lenders could elect to declare all amounts outstanding thereunder to be immediately due and payable and terminate all commitments to extend further credit thereunder. If the lenders under such indebtedness accelerate the repayment of borrowings, we cannot assure you that we will have sufficient assets to repay those borrowings, as well as our other indebtedness, including our outstanding notes. We have pledged a significant portion of our assets as collateral under our credit facilities. If we were unable to repay those amounts, the lenders under our credit facilities could proceed against the collateral granted to them to secure that indebtedness. Additional borrowings under the senior secured asset-based revolving credit facility will, if excess availability under that facility is less than a certain amount, be subject to the satisfaction of a specified financial ratio. Accordingly, our ability to access the full availability under our senior secured asset-based revolving credit facility may be constrained. Our ability to meet this financial ratio can be affected by events beyond our control, and we cannot assure you that we will meet this ratio, if applicable, and other covenants.

New accounting guidance or changes in the interpretation or application of existing accounting guidance could adversely affect our financial performance.

The implementation of proposed new accounting standards may require extensive systems, internal process and other changes that could increase our operating costs, and may also result in changes to our financial statements. In particular, the implementation of expected future accounting standards related to leases, as currently being contemplated by the convergence project between the Financial Accounting Standards Board ("FASB") and the International Accounting Standards Board ("IASB"), as well as the possible adoption of international financial reporting standards by U.S. registrants, could require us to make significant changes to our lease management, fixed asset, and other accounting systems, and in all likelihood would result in changes to our financial statements.

U.S. generally accepted accounting principles and related accounting pronouncements, implementation guidelines and interpretations with regard to a wide range of matters that are relevant to our business involve many subjective assumptions, estimates and judgments by our management. Changes in these rules or their interpretation or changes in underlying assumptions, estimates or judgments by our management could significantly change our reported or expected financial performance. The outcome of such changes could include litigation or regulatory actions which could have an adverse effect on our financial condition and results of operations.

Kohlberg Kravis Roberts & Co. L.P. (KKR), certain affiliates of Goldman, Sachs & Co. (the GS Investors), and other equity co-investors (collectively, the "Investors") have significant influence over us, including control over decisions that require the approval of shareholders, which could limit your ability to influence the outcome of key transactions, including a change of control.

We are controlled by the Investors. The Investors have an indirect interest in approximately 71% of our outstanding common stock through their investment in Buck

Holdings, L.P. In addition, the Investors have the ability to elect our entire Board of Directors. As a result, the Investors have control over our decisions to enter into any corporate transaction and the ability to prevent any transaction that requires shareholder approval regardless of whether others believe that the transaction is in our best interests. As long as the Investors continue to have an indirect interest in a majority of our outstanding common stock, they will have the ability to control the vote in any election of directors. In addition, pursuant to a shareholders agreement that we entered into with Buck Holdings, L.P., KKR and the GS Investors, KKR has a consent right over certain significant corporate actions and KKR and the GS Investors have certain rights to appoint directors to our Board and its committees.

The Investors are also in the business of making investments in companies and may from time to time acquire and hold interests in businesses that compete directly or indirectly with us. The Investors may also pursue acquisition opportunities that are complementary to our business, and, as a result, those acquisition opportunities may not be available to us. So long as the Investors, or other funds controlled by or associated with the Investors, continue to indirectly own a significant amount of our outstanding common stock, even if such amount is less than 50%, the Investors will continue to be able to strongly influence or effectively control our decisions. The concentration of ownership may have the effect of delaying, preventing or deterring a change of control of our company, could deprive shareholders of an opportunity to receive a premium for their common stock as part of a sale of our company and might ultimately affect the market price of our common stock.

If we, the Investors or other significant shareholders sell shares of our common stock, the market price of our common stock could decline.

The market price of our common stock could decline as a result of sales of a large number of shares of common stock in the market, or the perception that such sales could occur. These sales, or the possibility that these sales may occur, also might make it more difficult for us to issue equity securities in the future at a time and at a price that we deem appropriate. As of January 28, 2011, we had approximately 341.5 million shares of common stock outstanding, of which less than 29% were freely tradable on the New York Stock Exchange.

Pursuant to shareholders agreements, we have granted the Investors the right to cause us, in certain instances, at our expense, to file registration statements under the Securities Act of 1933, as amended, covering resales of our common stock held by them or to piggyback on a registration statement in certain circumstances. Certain members of management hold similar piggyback registration rights. Collectively, these shares represent approximately 71% of our outstanding common stock. To the extent that such registration rights are exercised, the resulting sale of a substantial number of shares of our common stock into the market could cause the market price of our common stock to decline. These shares also may be sold pursuant to Rule 144 under the Securities Act, depending on their holding period and subject to restrictions in the case of shares held by persons deemed to be our affiliates.

ITEM 1B.

UNRESOLVED STAFF COMMENTS

None.

ITEM 2.

PROPERTIES

As of February 25, 2011, we operated 9,414 retail stores located in 35 states as follows:

State	**Number of Stores**	**State**	**Number of Stores**
Alabama	512	Nebraska	79
Arizona	61	New Jersey	44

Arkansas	268
New Mexico	46
Colorado	27
New York	245
Delaware	29
North Carolina	536
Florida	505

Ohio	510
Georgia	541
Oklahoma	295
Illinois	352
Pennsylvania	421
Indiana	358
South Carolina	375
Iowa	

	169
South Dakota	12
Kansas	173
Tennessee	489
Kentucky	363
Texas	1,081
Louisiana	369
Utah	

	8
Maryland	72
Vermont	11
Michigan	270
Virginia	265
Minnesota	16
West Virginia	161
Mississippi	310

Wisconsin	93
Missouri	348

Most of our stores are located in leased premises. Individual store leases vary as to their terms, rental provisions and expiration dates. Many stores are subject to build-to-suit arrangements with landlords, which typically carry a primary lease term of 10-15 years with multiple renewal options. We also have stores subject to shorter-term leases (usually with initial or current terms of three to five years), and many of these leases have multiple renewal options as well. In recent years, an increasing percentage of our new stores have been subject to build-to-suit arrangements, including approximately 72% of our new stores in 2010.

As of February 25, 2011, we operated nine distribution centers, as described in the following table:

Location	**Year Opened**	**Approximate Square Footage**	**Approximate Number of Stores Served**

Scottsville, KY	1959	720,000	949
Ardmore, OK	1994	1,310,000	1,402
South Boston, VA	1997	1,250,000	895
Indianola, MS	1998	820,000	

809

Fulton, MO

1999

1,150,000

1,273

Alachua, FL

2000

980,000

876

Zanesville, OH

2001

1,170,000

1,229

Jonesville, SC	2005	1,120,000	981
Marion, IN	2006	1,110,000	1,000

We lease the distribution centers located in Oklahoma, Mississippi and Missouri and own the other six distribution centers. Approximately 7.25 acres of the land on which our Kentucky distribution center is located is subject to a ground lease. As of January 28, 2011, we leased approximately 600,000 square feet of additional temporary warehouse space to support our distribution needs.

Our executive offices are located in approximately 302,000 square feet of buildings in Goodlettsville, Tennessee which are owned by us.

ITEM 3.

LEGAL PROCEEDINGS

The information contained in Note 9 to the consolidated financial statements under the heading Legal proceedings contained in Part II, Item 8 of this report is incorporated herein by this reference.

EXECUTIVE OFFICERS OF THE REGISTRANT

Information regarding our current executive officers as of March 22, 2011 is set forth below. Each of our executive officers serves at the discretion of our Board of Directors and is elected annually by the Board to serve until a successor is duly elected. There are no familial relationships between any of our directors or executive officers.

Name	**Age**	**Position**
Richard W. Dreiling	57	Chairman and Chief Executive Officer
David M. Tehle	54	Executive Vice President and Chief Financial Officer
Kathleen R. Guion		

59

Executive Vice President, Division President, Store Operations and Store Development

Todd Vasos

49

Executive Vice President, Division President and Chief Merchandising Officer

John W. Flanigan

59

Executive Vice President, Global Supply Chain

Susan S. Lanigan

48

Executive Vice President and General Counsel

Robert D. Ravener

52

Executive Vice President and Chief People Officer

Anita C. Elliott

46

Senior Vice President and Controller

Mr. Dreiling joined Dollar General in January 2008 as Chief Executive Officer and a member of our Board. He was appointed Chairman of the Board on December 2, 2008. Prior to joining Dollar General, Mr. Dreiling served as Chief Executive Officer, President and a director of Duane Reade Holdings, Inc. and Duane Reade Inc., the largest drugstore chain in New York City, from November 2005 until January 2008 and as Chairman of the Board of Duane Reade from March 2007 until January 2008. Prior to that, Mr. Dreiling, beginning in March 2005, served as Executive Vice President Chief Operating Officer of Longs Drug Stores Corporation, an operator of a chain of retail drug stores on the West Coast and Hawaii, after having joined Longs in July 2003 as Executive Vice President and Chief Operations Officer. From 2000 to 2003, Mr. Dreiling served as Executive Vice President Marketing, Manufacturing and Distribution at Safeway, Inc., a food and drug retailer. Prior to that, Mr. Dreiling served from 1998 to 2000 as President of Vons, a Southern California food and drug division of Safeway.

Mr. Tehle joined Dollar General in June 2004 as Executive Vice President and Chief Financial Officer. He served from 1997 to June 2004 as Executive Vice President and Chief Financial Officer of Haggar Corporation, a manufacturing, marketing and retail corporation. From 1996 to 1997, he was Vice President of Finance for a division of The Stanley Works, one of the world's largest manufacturers of tools, and from 1993 to 1996, he was Vice President and Chief Financial Officer of Hat Brands, Inc., a hat manufacturer. Earlier in his career, Mr. Tehle served in a variety of financial-related roles at Ryder System, Inc. and Texas Instruments. Mr. Tehle currently serves as a director of Jack in the Box, Inc.

Ms. Guion joined Dollar General in October 2003 as Executive Vice President, Store Operations. She was named Executive Vice President, Store Operations and Store Development in February 2005, and was promoted to Executive Vice President, Division President, Store

Operations and Store Development in November 2005. From 2000 until joining Dollar General, Ms. Guion served as President and Chief Executive Officer of Duke and Long Distributing Company. Prior to that time, she served as an operating partner for Devon Partners (1999-2000), where she developed operating plans and assisted in the identification of acquisition targets in the convenience store industry, and as President and Chief Operating Officer of E-Z Serve Corporation (1997-1998), an owner/operator of convenience stores, mini-marts and gas marts. From 1987 to 1997, Ms. Guion served as the Vice President and General Manager of the largest division (Chesapeake Division) of company-owned stores at 7-Eleven, Inc., a convenience store chain. Other positions held by Ms. Guion during her tenure at 7-Eleven include District Manager, Zone Manager, Operations Manager, and Division Manager (Midwest Division).

Mr. Vasos joined Dollar General in December 2008 as Executive Vice President, Division President and Chief Merchandising Officer. Prior to joining Dollar General, Mr. Vasos served in executive positions with Longs Drug Stores Corporation for 7 years, including Executive Vice President and Chief Operating Officer (February 2008 through November 2008) and Senior Vice President and Chief Merchandising Officer (2001-2008), where he was responsible for all pharmacy and front-end marketing, merchandising, procurement, supply chain, advertising, store development, store layout and space allocation, and the operation of three distribution centers. He also previously served in leadership positions at Phar-Mor Food and Drug Inc. and Eckerd Drug Corp.

Mr. Flanigan joined Dollar General as Senior Vice President, Global Supply Chain, in May 2008. He was promoted to Executive Vice President in March 2010. He has 25 years of management experience in retail logistics. Prior to joining Dollar General, he was group vice president of logistics and distribution for Longs Drug Stores Corporation from October 2005 to April 2008. In this role, he was responsible for overseeing warehousing, inbound and outbound transportation and facility maintenance to service over 500 retail outlets. From September 2001 to October 2005 he served as the Vice President of Logistics for Safeway Inc. where he oversaw distribution of food products from Safeway distribution centers to all retail outlets, inbound traffic and transportation. He also held distribution and logistics leadership positions at Vons a Safeway company, Specialized Distribution Management Inc., and Crum & Crum Logistics.

Ms. Lanigan joined Dollar General in July 2002 as Vice President, General Counsel and Corporate Secretary. She was promoted to Senior Vice President in October 2003 and to Executive Vice President in March 2005. Prior to joining Dollar General, Ms. Lanigan served as Senior Vice President, General Counsel and Secretary at Zale Corporation, a specialty retailer of fine jewelry. During her six years with Zale, Ms. Lanigan held various positions, including Associate General Counsel. Prior to that, she held legal positions with both Turner Broadcasting System, Inc. and the law firm of Troutman Sanders LLP.

Mr. Ravener joined Dollar General as Senior Vice President and Chief People Officer in August 2008. He was promoted to Executive Vice President in March 2010. Prior to joining Dollar General, he served in human resources executive roles with Starbucks Coffee Company from September 2005 until August 2008 as both Senior Vice President of U.S. Partner Resources and as the Vice President, Partner Resources Eastern Division. As the Senior Vice President of U.S. Partner Resources at Starbucks, Mr. Ravener oversaw all aspects of human resources

activity for more than 10,000 stores. Prior to serving at Starbucks, Mr. Ravener held Vice President of Human Resources roles for The Home Depot's Store Support Center and a domestic field division from April 2003 to September 2005. Mr. Ravener also served in executive roles in both human resources and operations at Footstar, Inc. and roles of increasing leadership at PepsiCo.

Ms. Elliott joined Dollar General as Senior Vice President and Controller in August 2005. Prior to joining Dollar General, she served as Vice President and Controller of Big Lots, Inc., a closeout retailer, from May 2001 to August 2005. Overseeing a staff of 140 employees at Big Lots, she was responsible for accounting operations, financial reporting and internal audit. Prior to serving at Big Lots, she served as Vice President and Controller for Jitney-Jungle Stores of America, Inc., a grocery retailer, from April 1998 to March 2001. At Jitney-Jungle, Ms. Elliott was responsible for the accounting operations and the internal and external financial reporting functions. Prior to serving at Jitney-Jungle, she practiced public accounting for 12 years, 6 of which were with Ernst & Young LLP.

PART II

ITEM 5.

MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

Our common stock is traded on the New York Stock Exchange under the symbol DG. There was no established public trading market for our common stock after our merger that occurred on July 6, 2007 until our initial public offering of our common stock (IPO) on November 13, 2009. The range of the high and low sales prices of our common stock during our fourth quarter of fiscal 2009, as reported in the consolidated transaction reporting system, were $24.90 (high) and $21.75 (low). The high and low sales prices during fiscal 2010 were as follows:

	2010
	First Quarter

	Second Quarter	Third Quarter	Fourth Quarter
High	$ 29.91	$ 31.41	$ 30.20
	$ 33.73		
Low			

$ 21.30
$ 26.61
$ 26.64
$ 27.29

Our stock price at the close of the market on March 16, 2011, was $29.78. There were approximately 1,044 shareholders of record of our common stock as of March 16, 2011.

Dividends

We have not declared or paid recurring dividends since prior to our 2007 merger. However, prior to our IPO, on September 8, 2009, our Board of Directors declared a special dividend on our outstanding common stock of approximately $239.3 million in the aggregate. The special dividend was paid on September 11, 2009 to shareholders of record on September 8,

2009 with cash generated from operations. We have no current plans to pay any cash dividends on our common stock and instead may retain earnings, if any, for future operation and expansion and debt repayment. Any decision to declare and pay dividends in the future will be made at the discretion of our Board of Directors and will depend on, among other things, our results of operations, cash requirements, financial condition, contractual restrictions and other factors that our Board of Directors may deem relevant. In addition, our ability to pay dividends is limited by covenants in our Credit Facilities and in the indentures governing our outstanding 10.625% senior notes due 2015 (the Senior Notes) and 11.875%/12.625% senior subordinated toggle notes due 2017 (the Senior Subordinated Notes and, collectively with the Senior Notes, the Notes). See "Liquidity and Capital Resources" in the Management s Discussion and Analysis of Financial Condition and Results of Operations section of this report for a description of restrictions on our ability to pay dividends.

Issuer Purchases of Equity Securities

The following table contains information regarding purchases of our common stock made during the quarter ended January 28, 2011 by or on behalf of Dollar General or any affiliated purchaser, as defined by Rule 10b-18(a)(3) of the Securities Exchange Act of 1934:

Period	**Total Number of Shares Purchased (a)**	**Average Price Paid per Share**	**Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs**	**Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs**

10/30/10-11/30/10

-

$

-

-

-

12/01/10-12/31/10

11,270

$

29.34

-

-

1/1/11-1/28/11

-

$
-
-
-
Total
11,270
$
29.34
-
-

(a) Represents shares repurchased from employees pursuant to the terms of management stockholder s agreements.

ITEM 6.

SELECTED FINANCIAL DATA

The following table sets forth selected consolidated financial information of Dollar General Corporation as of the dates and for the periods indicated. The selected historical statement of operations data and statement of cash flows data for the fiscal years ended January 28, 2011, January 29, 2010 and January 30, 2009, and balance sheet data as of January 28, 2011 and January 29, 2010, have been derived from our historical audited consolidated financial statements included elsewhere in this report. The selected historical statement of operations data and statement of cash flows data for the fiscal years or periods, as applicable, ended February 1, 2008, July 6, 2007 and February 2, 2007 and balance sheet data as of January 30, 2009, February 1, 2008 and February 2, 2007 presented in this table have been derived from audited consolidated financial statements not included in this report.

We completed a merger with Buck Acquisition Corp. (BAC) on July 6, 2007, and, as a result, we are majority owned by a Delaware limited partnership controlled by investment funds affiliated with Kohlberg Kravis Roberts & Co. L.P. As a result of the merger, the related purchase accounting adjustments, and a new basis of accounting beginning on July 7, 2007, the 2007 financial reporting periods presented below include the Predecessor period of the Company reflecting 22 weeks of operating results from February 3, 2007 to July 6, 2007 and 30 weeks of operating results for the Successor period, reflecting the merger from July 7, 2007 to February 1, 2008. BAC s results of operations for the period from March 6, 2007 to July 6, 2007 (prior to the merger on July 6, 2007) are also included in the consolidated financial statements for the 2007 Successor period described above, as a result of certain derivative financial instruments entered into by BAC prior to the merger. Other than these financial instruments, BAC had no assets, liabilities, or operations prior to the merger. The 2006 fiscal year presented reflects the Predecessor.

Due to the significance of the merger and related transactions that occurred in 2007, the 2010, 2009, 2008 and 2007 Successor financial information is not comparable to that of the Predecessor periods presented in the accompanying table.

The information set forth below should be read in conjunction with, and is qualified by reference to, the Consolidated Financial Statements and related notes included in Part II, Item 8 of this report and the Management s Discussion and Analysis of Financial Condition and Results of Operations included in Part II, Item 7 of this report.

Successor

Predecessor

Year Ended

Year Ended

(Amounts in millions, excluding per share data, number of stores, selling square feet, and net sales per square foot)

January 28, 2011

January 29, 2010

January 30, 2009

	March 6, 2007 through February 1, 2008(1)(2)
	February 3, 2007 through July 6, 2007(2)
	February 2, 2007(2)
Statement of Operations Data:	
Net sales	$

13,035.0

$

11,796.4

$

10,457.7

$

5,571.5

$

3,923.8

$

9,169.8

Cost of goods sold

8,858.4

8,106.5

7,396.6

3,999.6

2,852.2

6,801.6

Gross profit

4,176.6

3,689.9

3,061.1

1,571.9

1,071.6

2,368.2

Selling, general and administrative expenses

2,902.5

2,736.6

2,448.6

1,324.5

960.9

2,119.9

Litigation settlement and related costs, net

-

-

32.0

-

-

-

Transaction and related costs

-

-

-

1.2

101.4

-

Operating profit

1,274.1

953.3

580.5

246.1

9.2

248.3

Interest income

(0.2)

(0.1)

(3.1)

(3.8)

(5.0)

(7.0)

Interest expense

274.2

345.7

391.9

252.9

10.3

34.9

Other (income) expense

15.1

55.5

(2.8)

3.6

-

-

Income (loss) before income taxes

985.0

552.1

194.4

(6.6)

4.0

220.4

Income tax expense (benefit)

357.1

212.7

86.2

(1.8)

12.0

82.4

Net income (loss)

$

627.9

$

339.4

$

108.2

$

(4.8)

$

(8.0)

$

137.9

Earnings (loss) per share basic	$ 1.84	$ 1.05	$ 0.34	$ (0.02)
Earnings (loss) per share - diluted				

1.82

1.04

0.34

(0.02)

Dividends per share

-

0.7525

-

-

Statement of Cash Flows Data:

Net cash provided by (used in):

Operating activities

$

824.7

$

672.8

$

575.2

$

239.6

$

201.9

$

405.4

Investing activities

(418.9)

(248.0)

(152.6)

(6,848.4)

(66.9)

(282.0)

Financing activities

(130.4)

(580.7)

(144.8)

6,709.0

25.3

(134.7)

Total capital
expenditures

(420.4)

(250.7)

(205.5)

(83.6)

(56.2)

(261.5)

Other Financial and Operating Data:

Same store sales growth (3)	4.9%	9.5%

9.0%
1.9%
2.6%
3.3%
Same store sales (3)
$
12,227.1
$
11,356.5
$
10,118.5
$
5,264.2
$
3,656.6
$
8,327.2
Number of stores included in same store sales calculation

8,712

8,324

8,153

7,735

7,655

7,627

Number of stores (at period end)

9,372

8,828

8,362

8,194

8,205

8,229

Selling square feet (in thousands at period end)	67,094	62,494	58,803	57,376	57,379	57,299
Net sales per square foot (4)	$ 201	$ 195	$ 180	$ 165	$ 164	

	$
	163
Consumables sales	
	71.6%
	70.8%
	69.3%
	66.4%
	66.7%
	65.7%
Seasonal sales	
	14.5%
	14.5%
	14.6%
	16.3%

	15.4%
	16.4%
Home products sales	
	7.0%
	7.4%
	8.2%
	9.1%
	9.2%
	10.0%
Apparel sales	
	6.9%
	7.3%
	7.9%
	8.2%

8.7%

7.9%

Rent expense

$

489.3

$

428.6

$

389.6

$

214.5

$

150.2

$

343.9

Balance Sheet Data (at period end):

Cash and cash equivalents and short-term investments	$	497.4	$	222.1	$

378.0

$

119.8

$

219.2

Total assets

9,546.2

8,863.5

8,889.2

8,656.4

3,040.5

Total debt

3,288.2

3,403.4

4,137.1

4,282.0

270.0

Total shareholders equity

4,054.5

3,390.3

2,831.7

2,703.9

1,745.7

(1)

Includes the results of BAC for the period prior to its merger with and into Dollar General Corporation from March 6, 2007 (the date of BAC s formation) through July 6, 2007 and the post-merger results of Dollar General Corporation for the period from July 7, 2007 through February 1, 2008.

(2)

Includes the effects of certain strategic merchandising and real estate initiatives that resulted in the closing of approximately 460 stores and changes in our inventory management model which resulted in greater inventory markdowns than in previous years.

(3)

Same-store sales are calculated based upon stores that were open at least 13 full fiscal months and remain open at the end of the reporting period. When applicable, we exclude the sales in the 53rd week of a 53-week year from the same-store sales calculation.

(4)

Net sales per square foot was calculated based on total sales for the preceding 12 months as of the ending date of the reporting period divided by the average selling square footage during the period, including the end of the fiscal year, the beginning of the fiscal year, and the end of each of our three interim fiscal quarters. For the period from February 3, 2007 through July 6, 2007, average selling square footage was calculated using the average square footage as of July 6, 2007 and as of the end of each of the four preceding quarters.

Successor

Predecessor

Year Ended

Year Ended

January 28, 2011

January 29, 2010

January 30, 2009

March 6, 2007 through February 1, 2008

February 3, 2007

through July 6, 2007
February 2, 2007
Ratio of earnings to fixed charges (1):
3.1x
2.1x
1.4x

(2)

1.1x

2.5x

(1)

For purposes of computing the ratio of earnings to fixed charges, (a) earnings consist of income (loss) before income taxes, plus fixed charges less capitalized expenses related to indebtedness (amortization expense for capitalized interest is not significant) and (b) fixed charges consist of interest expense (whether expensed or capitalized), the amortization of debt issuance costs and discounts related to indebtedness, and the interest portion of rent expense.

(2)

For the Successor period from March 6, 2007 through February 1, 2008, fixed charges exceeded earnings by $6.6 million.

ITEM 7.

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion and analysis should be read with, and is qualified in its entirety by, the Consolidated Financial Statements and the notes thereto. It also should be read in conjunction with the Cautionary Disclosure Regarding Forward-Looking Statements and the Risk Factors disclosures set forth in the Introduction and in Item 1A of this report, respectively.

Executive Overview

We are the largest discount retailer in the United States by number of stores, with 9,414 stores located in 35 states as of February 25, 2011, primarily in the southern, southwestern, midwestern and eastern United States. We offer a broad selection of merchandise, including consumable products such as food, paper and cleaning products, health and beauty products and pet supplies, and non-consumable products such as seasonal merchandise, home decor and domestics, and apparel. Our merchandise includes high quality national brands from leading manufacturers, as well as comparable quality private brand selections with prices at substantial discounts to national brands. We offer our customers these national brand and private brand products at everyday low prices (typically $10 or less) in our convenient small-box (small store) locations.

On July 6, 2007, we completed a merger and, as a result, we are majority owned by Buck Holdings, L.P. (Buck), a Delaware limited partnership controlled by investment funds affiliated with Kohlberg Kravis Roberts & Co. L.P. (collectively, KKR). The membership interests of Buck and Buck Holdings, LLC (Buck LLC), the general partner of Buck, are held by a private investor group, including affiliates of each of KKR and Goldman, Sachs & Co. and other equity investors (collectively, the Investors). The merger consideration was funded through the use of our available cash, cash equity contributions from the Investors, equity contributions of certain members of our management and certain debt financings discussed below under Liquidity and Capital Resources. In November 2009, we completed an initial public offering of approximately 39.2 million shares, including 22.7 million newly issued shares and approximately 16.5 million outstanding shares sold by Buck. In April and December of 2010, we completed secondary offerings of approximately 29.9 million and 28.8 million shares, respectively, all of which were sold by selling shareholders. We did not receive any proceeds from either of the secondary offerings in 2010.

The customers we serve are value-conscious, and Dollar General has always been intensely focused on helping our customers make the most of their spending dollars. We believe our convenient store format and broad selection of high quality products at compelling values have driven our substantial growth and financial success over the years. Like other companies, we have been operating in an environment with heightened economic challenges and uncertainties. Consumers are facing very high rates of unemployment, fluctuating food, gasoline and energy costs, rising medical costs, and a continued weakness in housing and credit markets, and the timetable for economic recovery is uncertain. Nonetheless, as a result of our long-term mission of serving the value-conscious customer, coupled with a vigorous focus on improving our operating and financial performance, our 2010 and 2009 financial results were strong, and we remain optimistic with regard to executing our operating priorities in 2011.

At the beginning of 2008, we defined four operating priorities, which we remain keenly focused on executing. These priorities are: 1) drive productive sales growth, 2) increase our gross margins, 3) leverage process improvements and information technology to reduce costs, and 4) strengthen and expand Dollar General's culture of serving others.

Our first priority is driving productive sales growth by increasing shopper frequency and transaction amount and maximizing sales per square foot. Our category management processes allow us to identify opportunities to add more productive items and remove unproductive items in a timely manner and have allowed us to continue expanding our consumables offerings while also improving profitability. We raised the shelf height in our stores in three phases from 2008 through 2010 in order to utilize the space in our stores more productively. We are adding a fourth phase in 2011. In addition, we believe we have significant potential to grow sales through new store growth in both existing and new markets. We opened 600 new stores in 2010 and plan to open approximately 625 new stores in 2011.

Our second priority is to increase gross profit through effective category management, the expansion of private brand offerings and increased foreign sourcing, shrink reduction, distribution efficiencies and improvements to our pricing and markdown model, while remaining committed to our everyday low price strategy. We constantly review our pricing strategy and work diligently to minimize vendor cost increases as we focus on providing our customers quality merchandise at great values. In our consumables category, we strive to offer the optimal balance of the most popular nationally advertised brands and our own private brands, which generally have higher gross profit rates than national brands. In 2011, we expect increased product costs. We saw the costs of certain commodities (including cotton, wheat, corn, sugar, coffee, resin) and the costs of diesel fuel begin to escalate in our 2010 fourth quarter. The market prices of these commodities, including the cost of diesel fuel, are outside of our control. However, we will be diligent in our efforts to keep product costs as low as possible in the face of these increases while still working to optimize gross profit and meet the needs of our customers.

Our third priority is leveraging process improvements and information technology to reduce costs. We are committed as an organization to extract costs that do not affect the customer experience. Examples of ongoing cost reduction initiatives include the installation of energy management systems, continued preventive maintenance with the goal of reducing overall repairs and maintenance costs, and recycling of cardboard to reduce waste management costs. Our real estate team continues to seek out opportunities to negotiate favorable lease renewals. We are focusing our information technology resources on improving systems to create greater efficiencies in merchandising and retail store operations, evidenced by our intention to implement a new store staffing module in 2011 to better align store labor hours with our customer s shopping needs. In 2010, we centralized our procurement system which we expect to aid us in reducing the cost of purchases throughout the company in 2011 and beyond. We plan to continue our diligent efforts with regard to our cost reduction initiatives in 2011.

Our fourth priority is to strengthen and expand Dollar General s culture of serving others. For customers this means helping them Save time. Save money. Every day! by providing clean, well-stocked stores with quality products at low prices. For employees, this means creating an environment that attracts and retains key employees throughout the organization. For the public, this means giving back to our store communities. For shareholders, this means meeting their expectations of an efficiently and profitably run organization that operates with compassion and integrity.

For the year ended January 28, 2011, our continued focus on our four priorities resulted in improved financial performance over the year ended January 29, 2010 in each of our key financial metrics, as follows. Basis points, as referred to below, are equal to 0.01 percent of total sales.

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Total sales in fiscal 2010 increased 10.5 percent over 2009. Sales in same-stores increased 4.9 percent, following a strong 9.5 percent increase in 2009. Customer traffic and average transaction amount increased in both 2010 and 2009. Average sales per square foot in 2010 were $201, up from $195 in 2009.

.

Gross profit, as a percentage of sales, was 32.0 percent in 2010, an increase of 76 basis points over 2009. This improvement was primarily attributable to increased purchase markups, net of increased markdowns, resulting from increased volume, which enabled us to lower our average costs from vendors. The improvement also reflected the continued impact of our comprehensive category management enhancements.

.

SG&A, as a percentage of sales, for fiscal 2010 was 22.3 percent compared to 23.2 percent in 2009. SG&A in 2009 included incremental expenses of $68.3 million, or 58 basis points, resulting from the termination of our sponsor advisory agreement and the accelerated vesting of certain equity-based compensation related to our initial public offering. SG&A in 2010 included incremental expenses of $19.7 million, or 15 basis points, resulting from costs related to two secondary offerings of our common stock during the year by certain of our shareholders. Excluding the impact of these costs, SG&A, as a percentage of sales declined primarily due to lower employee incentive compensation, which is based on financial targets set at the beginning of each fiscal year (our results exceeded those targets in 2010 but not to the same degree as in 2009), lower healthcare expense, and the impact of other cost reduction and

productivity initiatives which resulted in various expenses decreasing or increasing at a rate lower than the 10.5 percent increase in sales.

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Interest expense decreased by $71.5 million in 2010 to $274.2 million, primarily as the result of lower average outstanding long-term obligations. Net proceeds from our initial public offering and excess cash were utilized in our fiscal 2009 fourth quarter to voluntarily reduce long-term obligations by $725.9 million, and in 2010 we repurchased an additional $115.0 million of long-term obligations utilizing operating cash flow. Other non-operating expenses include charges totaling $14.7 million in 2010 and $55.3 million in 2009 resulting from these repurchases.

.

We reported net income of $627.9 million, or $1.82 per diluted share, for fiscal 2010, compared to net income of $339.4 million, or $1.04 per diluted share, in 2009. Charges relating to secondary stock offerings by certain of our shareholders, including the acceleration of certain equity appreciation rights, and losses from the repurchase of long-term obligations, reduced 2010 net income by $21.3 million, or $0.06 per diluted share. In 2009, charges resulting from the termination of our sponsor advisory agreement, the acceleration of certain equity-based compensation and the repurchase of long-term obligations, related to or resulting from our initial public offering, reduced net income by $82.9 million, or $0.26 per diluted share.

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We generated approximately $825 million of cash flows from operating activities in 2010, an increase of over 22 percent compared to 2009. Cash flow was primarily utilized to support our capital expenditures and repurchase long-term obligations.

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During 2010, we opened 600 new stores, remodeled or relocated 504 stores, and closed 56 stores, resulting in a store count of 9,372 on January 28, 2011.

As discussed in more detail below, in recent years, we have generated significant cash flows from operating activities. We have used a portion of these cash flows to pay down debt and to invest in new store growth through our traditional leased stores. During 2010 we made a strategic decision to purchase certain of our leased stores. We believe that the current environment in the real estate markets provides an opportunity to make these investments at levels which are expected to result in favorable returns and positively impact our operating results. We initiated the store purchase program in the second half of 2010 and have plans to purchase additional stores during 2011.

Like other companies, we face uncertainties with regard to the future impact of healthcare reform legislation, including the Patient Protection and Affordable Care Act and the HealthCare and Education Reconciliation Act of 2010, signed into law in March 2010, which will likely affect the cost associated with employer-sponsored medical plans. Specifically, this legislation requires that employers provide a minimum level of coverage for full-time employees or pay penalties. Some of the plan coverage requirements may have an impact on our costs such as bans on exclusions for pre-existing conditions, extension of dependent coverage to age 26, and caps on employee premium sharing costs. Certain coverage provisions do not go into effect until 2014, but there are a number of dependent coverage and insurance market reforms that took effect immediately. Although this legislation did not have a material effect on our consolidated financial statements in 2010, we continue to evaluate the impact it will have on our costs in future years, and those costs could be material. Due to the breadth and complexity of the healthcare reform legislation, the current lack of implementing regulations and interpretive guidance, the phased-in nature of the implementation, and uncertainty with respect to the outcome of pending litigation with respect to the legislation, it is difficult to predict its overall impact on our business in the coming years.

In 2011, we plan to continue to focus on our four key operating priorities. We will continue to refine and improve our store standards in order to increase sales, focusing on achieving a consistent look and feel across the chain. We have begun and will continue to measure customer satisfaction which will allow us to identify areas needing improvement. We expect to continue the process of raising the height of certain merchandise fixtures, allowing us to better utilize our store square footage. As part of our overall category management processes, we plan to further expand our private brand consumables offerings and to continue to upgrade the selection, quality and presentation of our private brand offerings in our apparel, seasonal and home categories, and we expect a greater impact on gross margin from our foreign sourcing efforts in 2011. As noted above, we expect cost increases in certain commodities, including diesel fuel, to present a challenge as we focus on improving our gross profit rate, while managing our everyday low prices.

We now have improved processes and tools in place to assist us in our ongoing inventory shrink reduction efforts. Our work on shrink remains a high priority, and we plan to use the information supplied by these analytical and monitoring tools to help improve on our recent successes.

With regard to leveraging information technology and process improvements to reduce costs, we will continue to focus on making improvements that benefit our merchandising and operations efforts, including item profitability analysis, merchandise selection and allocation and labor scheduling. In 2010, we completed the installation of back office computers in all of our stores, which we will utilize to improve reporting and communications with the stores and, consequently, we believe will assist in improving store productivity. Also in 2010, we completed the rollout of a new voice pick system in our distribution centers, allowing our distribution associates to communicate with warehouse software systems using speech recognition.

Finally, we are very pleased with the performance of our 2010 new stores, remodels and relocations, and in 2011 we plan to increase our new store openings to 625 stores within the 35 states in which we currently operate as well as three new states, Connecticut, Nevada and New Hampshire, and to increase our number of remodels or relocations to an additional 550 stores. With regard to planned new store openings, our criteria are based on numerous factors including, among other things, availability of appropriate sites, expected sales, lease terms, population demographics, competition, and the employment environment. We use various real estate site selection tools to determine target markets and optimum site locations within those markets. With respect to store relocations, we begin to evaluate a store for relocation opportunities approximately 18 months prior to the store s lease expiration using the same basic tools and criteria as those used for new stores. Remodels, which require a much smaller investment, are

determined based on the need, the opportunity for sales improvement at the location and an expectation of a desirable return on investment.

Key Financial Metrics. We have identified the following as our most critical financial metrics for 2011:

- Same-store sales growth;
- Sales per square foot;
- Gross profit, as a percentage of sales;
- Operating profit;
- Inventory turnover;
- Cash flow;
- Net income;
- Earnings per share;
- Earnings before interest, income taxes, depreciation and amortization; and
- Return on invested capital.

Readers should refer to the detailed discussion of our operating results below for additional comments on financial performance in the current year periods as compared with the prior year periods.

Results of Operations

Accounting Periods. The following text contains references to years 2010, 2009 and 2008, which represent fiscal years ended January 28, 2011, January 29, 2010 and January 30, 2009, respectively. Our fiscal year ends on the Friday closest to January 31. Fiscal years 2010, 2009 and 2008 were 52-week accounting periods.

Seasonality. The nature of our business is seasonal to a certain extent. Primarily because of sales of holiday-related merchandise, sales in our fourth quarter (November, December and January) have historically been higher than sales achieved in each of the first three quarters of the fiscal year. Expenses and, to a greater extent, operating profit vary by quarter. Results of a period shorter than a full year may not be indicative of results expected for the entire year. Furthermore, the seasonal nature of our business may affect comparisons between periods.

The following table contains results of operations data for fiscal years 2010, 2009 and 2008, and the dollar and percentage variances among those years.

2010 vs. 2009

2009 vs. 2008

(amounts in millions, except per share amounts)

2010

2009

2008

Amount

Change

% Change

Amount Change

% Change

Net sales by category:

Consumables

$

9,332.1

$

8,356.4

$

7,248.4

$

975.7

11.7

%

$

1,108.0

15.3

%

% of net sales

71.59%

70.84%

69.31%

Seasonal

1,887.9

1,711.5

1,521.5

176.4

10.3

190.0

12.5

% of net sales

14.48%

14.51%

14.55%

Home products
917.6
869.8
862.2
47.9
5.5
7.5
0.9
% of net sales
7.04%
7.37%
8.24%

Apparel

897.3

858.8

825.6

38.6

4.5

33.2

4.0

% of net sales

6.88%

7.28%

7.89%

Net sales

$

13,035.0

$

11,796.4

$

10,457.7

$

1,238.6

10.5

%

$

1,338.7

12.8

%

Cost of goods sold

8,858.4

8,106.5

7,396.6

751.9

9.3

709.9

9.6

% of net sales

67.96%

68.72%

70.73%

Gross profit

4,176.6

3,689.9

3,061.1

486.7

13.2

628.8

20.5

% of net sales	
	32.04%
	31.28%
	29.27%
Selling, general and administrative expenses	
	2,902.5
	2,736.6
	2,448.6

165.9

6.1

288.0

11.8

% of net sales

22.27%

23.20%

23.41%

Litigation settlement and related costs, net

-

-

32.0

-

-

(32.0)

-

% of net sales

-

-

0.31%

Operating profit
1,274.1
953.3
580.5
320.8
33.7
372.8
64.2
% of net sales
9.77%

8.08%

5.55%

Interest income

(0.2)

(0.1)

(3.1)

(0.1)

52.8

2.9

(95.3)

% of net sales

(0.00)%

(0.00)%

(0.03)%

Interest expense

274.2

345.7

391.9

(71.5)

(20.7)

(46.2)

(11.8)

% of net sales

2.10%

2.93%

3.75%

Other (income) expense
15.1
55.5
(2.8)
(40.4)
(72.8)
58.3
-
% of net sales
0.12%
0.47%
(0.03)%

Income before income taxes
985.0
552.1
194.4
432.9
78.4
357.7
184.0
% of net sales

7.56%

4.68%

1.86%

Income taxes

357.1

212.7

86.2

144.4

67.9

126.5

146.7

% of net sales

2.74%

1.80%

0.82%

Net income

$

627.9

$

339.4

$

108.2

$

288.4

85.0

%

$

231.3

213.8

%

% of net sales

4.82%

2.88%

1.03%

Diluted earnings per share
$
1.82
$
1.04
$
0.34
$
0.78
75.0
%
$
0.70
205.9
%

Net Sales. The net sales increase in 2010 reflects a same-store sales increase of 4.9% compared to 2009. Same-stores include stores that have been open for 13 months and remain open at the end of the reporting period. For 2010, there were 8,712 same-stores which accounted for sales of $12.23 billion. The remainder of the increase in sales in 2010 was attributable to new stores, partially offset by sales from closed stores. The increase in sales reflects the continued refinement of our merchandise offerings, the optimization of our category management processes, further improvement in store standards, and increased utilization of square footage in our stores.

The net sales increase in 2009 reflects a same-store sales increase of 9.5% compared to 2008. For 2009, there were 8,324 same-stores which accounted for sales of $11.36 billion. The

remainder of the increase in sales in 2009 was attributable to new stores, partially offset by sales from closed stores. The strong increase in sales reflects the results of our various initiatives implemented throughout 2008 and 2009, including the impact of improved store standards, the expansion of our merchandise offerings, including significant enhancements to our convenience food and beverages and health and beauty products, in addition to improved utilization of square footage, extended store hours and improved marketing efforts.

Of our four major merchandise categories, the consumables category has grown most significantly over the past several years. Although this category generally has a lower gross profit rate than the other three categories, as discussed below, we were able to increase our overall gross profit rate in both 2010 and 2009 as compared to the previous year. Because of the impact of sales mix on gross profit, we continually review our merchandise mix and strive to adjust it when appropriate. Maintaining an appropriate sales mix is an integral part of achieving our gross profit and sales goals. Both the number of customer transactions and average transaction amount increased in 2010 and 2009, and we believe that our stores have benefited to some degree from attracting new customers who are seeking value as a result of the recent economic environment.

Gross Profit. The gross profit rate as a percentage of sales was 32.0% in 2010 compared to 31.3% in 2009. Factors contributing to the increase in the 2010 gross profit rate include increased markups resulting primarily from higher purchase markups, partially offset by increased markdowns, as well as our category management efforts and increased sales volumes which have contributed to our ability to reduce purchase costs from our vendors. Our merchandising team continues to work closely with our vendors to provide quality merchandise at value prices to meet our customers demands. In 2010 we recorded a LIFO provision of $5.3 million, reflecting an increase in certain merchandise costs, the most significant of which occurred in the 2010 fourth quarter, compared to a LIFO benefit of $2.5 million in 2009.

The gross profit rate as a percentage of sales was 31.3% in 2009 compared to 29.3% in 2008. Factors contributing to the increase in the 2009 gross profit rate include increased markups resulting primarily from higher purchase markups, partially offset by increased markdowns. In addition, our increased sales volumes have contributed to our ability to reduce purchase costs from our vendors. Transportation and distribution costs decreased for the year driven by lower fuel costs as well as the impact of cost reduction initiatives. Higher sales volumes and productivity initiatives also contributed to improved leverage of our distribution costs. In addition, inventory shrinkage as a percentage of sales declined in 2009 from 2008, contributing to our gross profit rate improvement. In 2009 we recorded a LIFO benefit of $2.5 million, reflecting a flattening of merchandise costs in 2009, compared to a LIFO provision of $43.9 million in 2008, when we faced increased commodity cost pressures mainly related to food and pet products which were driven by rising fruit and vegetable prices and freight costs. Increases in petroleum, resin, metals, pulp and other raw material commodity driven costs also resulted in multiple product cost increases in 2008. Also in 2008, we marked down merchandise as the result of our interpretation of the phthalates provision of the Consumer Product Safety Improvement Act of 2008, resulting in a charge of $8.6 million.

Selling, General and Administrative (SG&A) Expense. SG&A expense was 22.3% as a percentage of sales in 2010 compared to 23.2% in 2009, a decrease of 93 basis points. SG&A in

2010 included expenses totaling $19.7 million, or 15 basis points, relating to two secondary offerings of our common stock, consisting of $1.1 million of legal and other transaction expenses and $18.6 million relating to the acceleration of certain equity appreciation rights. SG&A in 2009 included expenses totaling $68.3 million, or 58 basis points, including $58.8 million relating to the termination of an advisory agreement among us, KKR and Goldman, Sachs & Co. and $9.4 million resulting from the acceleration of certain equity based compensation related to the completion of our initial public offering. Decreases in incentive compensation, the cost of health benefits, consulting fees and severance costs contributed to the overall decrease in SG&A as a percentage of sales, as did other cost reduction and productivity initiatives. Other costs increasing at a rate lower than our 10.5% increase in sales include utilities, which reflect lower waste management costs resulting from our recycling efforts, as well as repairs and maintenance. Our increased sales levels in 2010 also favorably impacted SG&A, as a percentage of sales. Debit card fees increased at a higher rate than the increase in sales, primarily as a result of increased usage.

SG&A, as a percentage of sales, was 23.2% in 2009 compared to 23.4% in 2008, representing an improvement of 21 basis points before taking into account the impact of our initial public offering as discussed above. Our increased sales levels in 2009 favorably impacted SG&A, as a percentage of sales, with the most significant impact on store occupancy costs, including rent and utilities. Our cost of utilities, as a percentage of sales, was further reduced by energy savings resulting from our store energy management initiatives, including forward purchase contracts, increased preventive maintenance and the installation of energy management systems in substantially all of our new and relocated stores. In addition, we continued to significantly reduce our workers compensation expense through safety initiatives implemented over the last several years, and legal expenses were lower in 2009 than 2008, which included expenses incurred in connection with a shareholder litigation settlement in 2008 relating to our 2007 merger. Also during 2008, we recorded a $5.0 million gain relating to potential losses on distribution center leases indirectly related to our 2007 merger.

Litigation Settlement and Related Costs, Net. Expenses in 2008 included $32.0 million which represents the settlement of a class action lawsuit filed in response to our 2007 merger, and includes a $40.0 million settlement plus related expenses of $2.0 million, net of $10.0 million of insurance proceeds received in the fourth quarter of 2008.

Interest Expense. The decrease in interest expense in 2010 compared to 2009 was primarily the result of lower average outstanding long-term obligations. The decrease in interest expense in 2009 compared to 2008 was primarily the result of lower average outstanding long-term obligations and lower interest rates on our term loan.

We had outstanding variable-rate debt of $931 million and $560 million as of January 28, 2011 and January 29, 2010, respectively, after taking into consideration the impact of interest rate swaps. The remainder of our outstanding indebtedness at January 28, 2011 and January 29, 2010 was fixed rate debt.

See the detailed discussion under Liquidity and Capital Resources regarding indebtedness incurred to finance our 2007 merger along with subsequent repurchases of various long-term obligations and the related effect on interest expense in the periods presented.

Other (Income) Expense. In 2010, we recorded pretax losses of $14.7 million resulting from the repurchase in the open market of $115.0 million aggregate principal amount of our Senior Notes plus accrued and unpaid interest.

In 2009, we recorded charges totaling $55.5 million, which primarily represents losses on debt retirement totaling $55.3 million, and also includes expense of $0.6 million related to hedge ineffectiveness on certain of our interest rate swaps.

In 2008, we recorded a gain of $3.8 million resulting from the repurchase of $44.1 million of our senior subordinated notes, offset by expense of $1.0 million related to hedge ineffectiveness on certain of our interest rate swaps.

Income Taxes. The effective income tax rates for 2010, 2009 and 2008 were expenses of 36.3%, 38.5%, and 44.4%, respectively.

The 2010 effective tax rate is greater than the expected tax rate of 35% due primarily to the inclusion of state income taxes in the total effective tax rate. The 2010 effective rate is less than the 2009 rate due principally to reductions in state income tax expense, income tax related interest expense and other expense items. The 2010 effective resolution of various examinations by the taxing authorities, when combined with unfavorable examination results in 2009, resulted in a decrease in the year-to-year state income tax expense rate. This decrease in state income tax expense was partially offset by an increase in state income tax expense due to a shift in income to companies within the group that have a higher effective state income tax rate. In addition, decreases also occurred due to favorable outcomes in 2010 associated with reductions in income tax related interest accruals and income tax related penalty accruals due to favorable income tax examination results, the completion of a federal income tax examination, and reductions in expense associated with uncertain tax benefit accruals.

The 2009 effective tax rate is greater than the expected tax rate of 35% due primarily to the inclusion of state income taxes in the total effective tax rate. The 2009 effective tax rate is less than the 2008 rate due principally to the unfavorable impact that the non-deductible, merger-related lawsuit settlement had on the 2008 rate. This reduction in the effective tax rate was partially offset by a decrease in the tax rate benefit related to federal jobs credits. While the total amount of jobs credits earned in 2009 was similar to the amount earned in 2008, the impact of this benefit on the effective tax rate was reduced due to the 2009 increase in income before tax. The 2009 rate was also increased by accruals associated with uncertain tax benefits.

The 2008 effective income tax rate was greater than the expected tax rate of 35% principally due to the non-deductibility of the settlement and related expenses associated with the shareholder lawsuit related to our 2007 merger.

Off Balance Sheet Arrangements

We lease three of our distribution centers. The entities involved in the ownership structure underlying these leases meet the accounting definition of a Variable Interest Entity (VIE). One of these distribution centers has been recorded as a financing obligation whereby its property and equipment are reflected in our consolidated balance sheets. The land and

42

buildings of the other two distribution centers have been recorded as operating leases. We are not the primary beneficiary of these VIEs and, accordingly, have not included these entities in our consolidated financial statements. Other than the foregoing, we are not party to any off balance sheet arrangements.

Effects of Inflation

In 2008, increased commodity cost pressures mainly related to food and pet products, which were driven by fruit and vegetable prices and rising freight costs, increased the costs of certain products. Increases in petroleum, resin, metals, pulp and other raw material commodity driven costs also resulted in multiple product cost increases. We believe that our ability to increase selling prices in response to cost increases largely mitigated the effect of these cost increases on our overall results of operations. These 2008 trends generally reversed or stabilized in 2009 and 2010.

Liquidity and Capital Resources

Current Financial Condition and Recent Developments

During the past three years, we have generated an aggregate of approximately $2.07 billion in cash flows from operating activities. During that period, we expanded the number of stores we operate by 1,178, or over 14%, remodeled or relocated 1,358 stores, or approximately 14% of stores we operated as of February 25, 2011, and incurred approximately $877 million in capital expenditures. We made certain strategic decisions which slowed our store growth in 2007 and 2008, but we reaccelerated store growth beginning in 2009 and currently plan to continue that strategy in 2011 and beyond.

At January 28, 2011, we had total outstanding debt (including the current portion of long-term obligations) of $3.29 billion. We also had an additional $959.3 million available for borrowing under our senior secured asset-based revolving credit facility (ABL Facility and, together with the Term Loan Facility, the Credit Facilities) at that date. Our liquidity needs are significant, primarily due to our debt service and other obligations. Our substantial debt could adversely affect our ability to raise additional capital to fund our operations, limit our ability to react to changes in the economy or our industry or to pursue our growth strategy, expose us to interest rate risk to the extent of our variable rate debt, and increase the difficulty of our ability to make payments on our outstanding debt securities.

Nevertheless, management believes our cash flow from operations and existing cash balances, combined with availability under the Credit Facilities (described below), will provide sufficient liquidity to fund our current obligations, projected working capital requirements and capital spending for a period that includes the next twelve months and the next several years.

Credit Facilities

Overview. We have two senior secured credit facilities which provide financing of up to $2.995 billion as of January 28, 2011. The Credit Facilities consist of the $1.964 billion Term Loan Facility and the $1.031 billion ABL Facility (of which up to $350.0 million is available for letters of credit), subject to borrowing base availability. The ABL Facility includes borrowing capacity available for letters of credit and for short-term borrowings referred to as swingline loans.

The amount available under the ABL Facility (including letters of credit) shall not exceed the sum of the tranche A borrowing base and the tranche A-1 borrowing base. The tranche A borrowing base equals the sum of (i) 85% of the net orderly liquidation value of all our eligible inventory and that of each guarantor thereunder and (ii) 90% of all our accounts receivable and credit/debit card receivables and that of each guarantor thereunder, in each case, subject to customary reserves and eligibility criteria. An additional 10% of the net orderly liquidation value of all of our eligible inventory and that of each guarantor thereunder is made available to us in the form of a last out tranche under which we may borrow up to a maximum amount of $101.0 million. Borrowings under the ABL Facility will be incurred first under the last out tranche, and no borrowings will be permitted under any other tranche until the last out tranche is fully utilized. Repayments of the ABL Facility will be applied to the last out tranche only after all other tranches have been fully paid down.

Interest Rates and Fees. Borrowings under the Credit Facilities bear interest at a rate equal to an applicable margin plus, at our option, either (a) LIBOR or (b) a base rate (which is usually equal to the prime rate). The applicable margin for borrowings is (i) under the Term Loan Facility, 2.75% for LIBOR borrowings and 1.75% for base-rate borrowings (ii) under the ABL Facility (except in the last out tranche described above) as of January 28, 2011 and January 29, 2010, 1.25% for LIBOR borrowings; 0.25% for base-rate borrowings and for any last out borrowings, 2.25% for LIBOR borrowings and 1.25% for base-rate borrowings. The applicable margins for borrowings under the ABL Facility (except in the case of last out borrowings) are subject to adjustment each quarter based on average daily excess availability under the ABL Facility. The interest rate for borrowings under the Term Loan Facility was 3.0% (without giving effect to the market rate swaps discussed below) as of both January 28, 2011 and January 29, 2010, respectively. We are also required to pay a commitment fee to the lenders under the ABL Facility for any unutilized commitments at a rate of 0.375% per annum. We also must pay customary letter of credit fees. See Item 7A. Quantitative and Qualitative Disclosures About Market Risk below for a discussion of our use of interest rate swaps to manage our interest rate risk.

Prepayments. The senior secured credit agreement for the Term Loan Facility requires us to prepay outstanding term loans, subject to certain exceptions, with:

.

50% of our annual excess cash flow (as defined in the credit agreement) which will be reduced to 25% and 0% if we achieve and maintain a total net leverage ratio of 6.0 to 1.0 and 5.0 to 1.0, respectively;

.

100% of the net cash proceeds of all non-ordinary course asset sales or other dispositions of property in excess of $25.0 million in the aggregate and subject to our right to reinvest the proceeds; and

.

100% of the net cash proceeds of any incurrence of debt, other than proceeds from debt permitted under the senior secured credit agreement.

The mandatory prepayments discussed above will be applied to the Term Loan Facility as directed by the senior secured credit agreement. Through January 28, 2011, no prepayments have been required under the prepayment provisions listed above. The Term Loan Facility can be prepaid in whole or in part at any time.

In addition, the senior secured credit agreement for the ABL Facility requires us to prepay the ABL Facility, subject to certain exceptions, as follows:

.

With 100% of the net cash proceeds of all non-ordinary course asset sales or other dispositions of Revolving Facility Collateral (as defined below) in excess of $1.0 million in the aggregate and subject to our right to reinvest the proceeds; and

.

To the extent such extensions of credit exceed the then current borrowing base (as defined in the senior secured credit agreement for the ABL Facility).

The mandatory prepayments discussed above will be applied to the ABL Facility as directed by the senior secured credit agreement for the ABL Facility. Through January 28, 2011, no prepayments have been required under the prepayment provisions listed above.

An event of default under the senior secured credit agreements will occur upon a change of control as defined in the senior secured credit agreements governing our Credit Facilities. Upon an event of default, indebtedness under the Credit Facilities may be accelerated, in which case we will be required to repay all outstanding loans plus accrued and unpaid interest and all other amounts outstanding under the Credit Facilities.

Amortization. The original terms of the Term Loan Facility required quarterly payments of principal beginning September 30, 2009. As a result of voluntary prepayments under the Term Loan Facility, no further quarterly principal installments will be required prior to maturity of the Term Loan on July 6, 2014. There is no amortization under the ABL Facility. The entire principal amounts (if any) outstanding under the ABL Facility are due and payable in full at maturity, on July 6, 2013, on which day the commitments thereunder will terminate.

Guarantee and Security. All obligations under the Credit Facilities are unconditionally guaranteed by substantially all of our existing and future domestic subsidiaries (excluding certain immaterial subsidiaries and certain subsidiaries designated by us under our senior secured credit agreements as unrestricted subsidiaries), referred to, collectively, as U.S. Guarantors.

All obligations and related guarantees under the Term Loan Facility are secured by:

.

a second-priority security interest in all existing and after-acquired inventory, accounts receivable, and other assets arising from such inventory and accounts receivable, of our company and each U.S. Guarantor (the Revolving Facility Collateral), subject to certain exceptions;

.

a first-priority security interest in, and mortgages on, substantially all of our and each U.S. Guarantor s tangible and intangible assets (other than the Revolving Facility Collateral); and

.

a first-priority pledge of 100% of the capital stock held by us, or any of our domestic subsidiaries that are directly owned by us or one of the U.S. Guarantors and 65% of the voting capital stock of each of our existing and future foreign subsidiaries that are directly owned by us or one of the U.S. Guarantors.

All obligations and related guarantees under the ABL Facility are secured by the Revolving Facility Collateral, subject to certain exceptions.

Certain Covenants and Events of Default. The senior secured credit agreements contain a number of covenants that, among other things, restrict, subject to certain exceptions, our ability to:

.

incur additional indebtedness;

.

sell assets;

.

pay dividends and distributions or repurchase our capital stock;

.

make investments or acquisitions;

.

repay or repurchase subordinated indebtedness (including the Senior Subordinated Notes discussed below) and the Senior Notes discussed below;

.

amend material agreements governing our subordinated indebtedness (including the Senior Subordinated Notes discussed below) or our Senior Notes discussed below;

.

change our lines of business.

The senior secured credit agreements also contain certain customary affirmative covenants and events of default.

At January 28, 2011, we had no borrowings, $52.7 million of standby letters of credit, and $19.1 million of commercial letters of credit, outstanding under our ABL Facility.

Senior Notes due 2015 and Senior Subordinated Toggle Notes due 2017

Overview. As of January 28, 2011, we have $864.3 million aggregate principal amount of 10.625% senior notes due 2015 (the Senior Notes) outstanding (reflected in our consolidated balance sheet net of a $11.2 million discount), which mature on July 15, 2015, pursuant to an indenture dated as of July 6, 2007 (the senior indenture), and $450.7 million aggregate principal amount of 11.875%/12.625% senior subordinated toggle notes due 2017 (the Senior Subordinated Notes) outstanding, which mature on July 15, 2017, pursuant to an indenture dated as of July 6, 2007 (the senior subordinated indenture). The Senior Notes and the Senior Subordinated Notes are collectively referred to herein as the Notes. The senior indenture and the senior subordinated indenture are collectively referred to herein as the indentures.

Interest on the Notes is payable on January 15 and July 15 of each year. Interest on the Senior Notes is payable in cash. Cash interest on the Senior Subordinated Notes accrues at a rate of 11.875% per annum. For the Senior Subordinated Notes, we previously had the ability to elect to pay interest by increasing the principal amount of the Senior Subordinated Notes or issuing new Senior Subordinated Notes (PIK interest) instead of paying cash interest. Due to the expiration of the notification period for such option, all interest on the Notes has been and will be paid in cash.

The Notes are fully and unconditionally guaranteed by each of the existing and future direct or indirect wholly owned domestic subsidiaries that guarantee the obligations under our Credit Facilities.

We intend to redeem some or all of the Senior Notes at the first scheduled call date in July 2011 or later. We may redeem some or all of the Notes at any time at redemption prices described or set forth in the indentures. We also may seek, from time to time, to retire some or all of the Notes through cash purchases on the open market, in privately negotiated transactions or otherwise. Such repurchases, if any, will depend on prevailing market conditions, our liquidity requirements, contractual restrictions and other factors. The amounts involved may be material. We repurchased $115.0 million aggregate principal amount of outstanding Senior Notes during 2010. In connection with our initial public offering in 2009, we redeemed $195.7 million principal amount of outstanding Senior Notes and $205.2 million principal amount of outstanding Senior Subordinated Notes. We repurchased $44.1 million and $25.0 million of Senior Subordinated Notes in 2008 and 2007, respectively.

Change of Control. Upon the occurrence of a change of control, which is defined in the indentures, each holder of the Notes has the right to require us to repurchase some or all of such holder s Notes at a purchase price in cash equal to 101% of the principal amount thereof, plus accrued and unpaid interest, if any, to the repurchase date.

Covenants. The indentures contain covenants limiting, among other things, our ability and the ability of our restricted subsidiaries to (subject to certain exceptions):

.

incur additional debt, issue disqualified stock or issue certain preferred stock;

.

pay dividends and or make certain distributions, investments and other restricted payments;

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create certain liens or encumbrances;

.

sell assets;

.

enter into transactions with our affiliates;

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allow payments to us by our restricted subsidiaries;

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consolidate, merge, sell or otherwise dispose of all or substantially all of our assets; and

.

designate our subsidiaries as unrestricted subsidiaries.

Events of Default. The indentures also provide for events of default which, if any of them occurs, would permit or require the principal of and accrued interest on the Notes to become or to be declared due and payable.

Adjusted EBITDA

Under the agreements governing the Credit Facilities and the indentures, certain limitations and restrictions could arise if we are not able to satisfy and remain in compliance with specified financial ratios. Management believes the most significant of such ratios is the senior secured incurrence test under the Credit Facilities. This test measures the ratio of the senior secured debt to Adjusted EBITDA. This ratio would need to be no greater than 4.25 to 1 to avoid such limitations and restrictions. As of January 28, 2011, this ratio was 1.0 to 1. Senior secured debt is defined as our total debt secured by liens or similar encumbrances less cash and cash equivalents. EBITDA is defined as income (loss) from continuing operations before cumulative effect of change in accounting principle plus interest and other financing costs, net, provision for income taxes, and depreciation and amortization. Adjusted EBITDA is defined as EBITDA, further adjusted to give effect to adjustments required in calculating this covenant ratio under our Credit Facilities. EBITDA and Adjusted EBITDA are not presentations made in accordance with generally accepted accounting principles in the United States (U.S. GAAP), are not measures of financial performance or condition, liquidity or profitability, and should not be considered as an alternative to (i) net income, operating income or any other performance measures determined in accordance with U.S. GAAP or (ii) operating cash flows determined in accordance with U.S. GAAP. Additionally, EBITDA and Adjusted EBITDA are not intended to be measures of free cash flow for management s discretionary use, as they do not consider certain cash requirements such as interest payments, tax payments and debt service requirements and replacements of fixed assets.

Our presentation of EBITDA and Adjusted EBITDA has limitations as an analytical tool, and should not be considered in isolation or as a substitute for analysis of our results as reported under U.S. GAAP. Because not all companies use identical calculations, these presentations of EBITDA and Adjusted EBITDA may not be comparable to other similarly titled measures of other companies. We believe that the presentation of EBITDA and Adjusted EBITDA is appropriate to provide additional information about the calculation of this financial ratio in the Credit Facilities. Adjusted EBITDA is a material component of this ratio. Specifically, non-compliance with the senior secured indebtedness ratio contained in our Credit Facilities could prohibit us, subject to specified exceptions, from making investments, incurring liens, making certain restricted payments and incurring additional secured indebtedness (other than the additional funding provided for under the senior secured credit agreement).

The calculation of Adjusted EBITDA under the Credit Facilities is as follows:

(in millions)	Year Ended January 28, 2011		Year Ended January 29, 2010	
Net income	$	627.9	$	339.4
Add (subtract):				
Interest income		(0.2)		(0.1)
Interest expense		274.1		

	345.6	
Depreciation and amortization	242.3	241.7
Income taxes	357.1	212.7
EBITDA	1,501.2	1,139.3
Adjustments:		

Loss on debt retirements	14.6	55.3
Loss on hedging instruments	0.4	0.5
Impact of markdowns related to inventory clearance activities, net of purchase accounting adjustments	-	(7.3)
Advisory and consulting fees to affiliates		

	0.1
	63.5
Non-cash expense for share-based awards	
	16.0
	18.7
Indirect merger-related costs	
	1.3
	10.6
Other non-cash charges (including LIFO)	
	11.5
	6.6
Total Adjustments	
	43.9

		147.9
Adjusted EBITDA	$ 1,545.1	$ 1,287.2

Interest Rate Swaps

We use interest rate swaps to minimize the risk of adverse changes in interest rates. These swaps are intended to reduce risk by hedging an underlying economic exposure. Because of high correlation between the derivative financial instrument and the underlying exposure being hedged, fluctuations in the value of the financial instruments are generally offset by reciprocal changes in the value of the underlying economic exposure. Our principal interest rate exposure relates to outstanding amounts under our Credit Facilities. At January 28, 2011, we had interest rate swaps with a total notional amount of approximately $1.05 billion. For more information see Item 7A Quantitative and Qualitative Disclosures about Market Risk below.

Fair Value Accounting

We have classified our interest rate swaps, as further discussed in Item 7A. below, in Level 2 of the fair value hierarchy, as the significant inputs to the overall valuations are based on market-observable data or information derived from or corroborated by market-observable data, including market-based inputs to models, model calibration to market-clearing transactions, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency. Where models are used, the selection of a particular model to value a derivative depends upon the contractual terms of, and specific risks inherent in, the instrument as well as the availability of pricing information in the market. We use similar models to value similar instruments. Valuation models require a variety of inputs, including contractual terms, market prices, yield curves, credit curves, measures of volatility, and correlations of such inputs. For our

derivatives, all of which trade in liquid markets, model inputs can generally be verified and model selection does not involve significant management judgment.

We incorporate credit valuation adjustments to appropriately reflect both our own nonperformance risk and the respective counterparty s nonperformance risk in the fair value measurements of our derivatives. The credit valuation adjustments are calculated by determining the total expected exposure of the derivatives (which incorporates both the current and potential future exposure) and then applying each counterparty s credit spread to the applicable exposure. For derivatives with two-way exposure, such as interest rate swaps, the counterparty s credit spread is applied to our exposure to the counterparty, and our own credit spread is applied to the counterparty s exposure to us, and the net credit valuation adjustment is reflected in our derivative valuations. The total expected exposure of a derivative is derived using market-observable inputs, such as yield curves and volatilities. The inputs utilized for our own credit spread are based on implied spreads from our publicly-traded debt. For counterparties with publicly available credit information, the credit spreads over LIBOR used in the calculations represent implied credit default swap spreads obtained from a third party credit data provider. In adjusting the fair value of our derivative contracts for the effect of nonperformance risk, we have considered the impact of netting and any applicable credit enhancements, such as collateral postings, thresholds, mutual puts, and guarantees. Additionally, we actively monitor counterparty credit ratings for any significant changes.

As of January 28, 2011, the net credit valuation adjustments reduced the settlement values of our derivative liabilities by $0.7 million. Various factors impact changes in the credit valuation adjustments over time, including changes in the credit spreads of the parties to the contracts, as well as changes in market rates and volatilities, which affect the total expected exposure of the derivative instruments. When appropriate, valuations are also adjusted for various factors such as liquidity and bid/offer spreads, which factors we deemed to be immaterial as of January 28, 2011.

Contractual Obligations

The following table summarizes our significant contractual obligations and commercial commitments as of January 28, 2011 (in thousands):

	Payments Due by Period
Contractual obligations	
	Total
	1 year
	1-3 years
	3-5 years
	5+ years
Long-term debt obligations	
	$
	3,293,025
	$
	-
	$
	-
	$
	2,827,923

	$ 465,102
Capital lease obligations	6,363
	1,157
	999
	679
	3,528
Interest (a)	1,093,039
	243,435

486,754

282,408

80,442

Self-insurance liabilities (b)

213,736

78,540

85,881

30,265

19,050

Operating leases (c)

3,003,342

481,921

839,585

614,080

1,067,756

Subtotal

$

7,609,505

$

805,053

$

1,413,219

$

3,755,355

$

1,635,878

Commitments Expiring by Period

Commercial commitments (d)

Total

1 year

1-3 years

3-5 years

5+ years

Letters of credit

$

19,059

$

19,059

$

-

$

-

$

-

Purchase obligations (e)

853,862

850,871

2,991

-

-

Subtotal

$

872,921

$

869,930

$

2,991

$

-

$

-

Total contractual obligations and commercial commitments (f)

$

8,482,426

$

1,674,983

$

1,416,210

$

3,755,355

$

1,635,878

(a)

Represents obligations for interest payments on long-term debt and capital lease obligations, and includes projected interest on variable rate long-term debt, using 2010 year end rates.

(b)

We retain a significant portion of the risk for our workers compensation, employee health insurance, general liability, property loss and automobile insurance. As these obligations do not have scheduled maturities, these amounts represent undiscounted estimates based upon actuarial assumptions. Reserves for workers compensation and general liability which existed as of the date of our 2007 merger were discounted in order to arrive at estimated fair value. All other amounts are reflected on an undiscounted basis in our consolidated balance sheets.

(c)

Operating lease obligations are inclusive of amounts included in deferred rent and closed store obligations in our consolidated balance sheets.

(d)

Commercial commitments include information technology license and support agreements, supplies, fixtures, letters of credit for import merchandise, and other inventory purchase obligations.

(e)

Purchase obligations include legally binding agreements for software licenses and support, supplies, fixtures, and merchandise purchases (excluding such purchases subject to letters of credit).

(f)

We have potential payment obligations associated with uncertain tax positions that are not reflected in these totals. We anticipate that approximately $0.2 million of such amounts will be paid in the coming year. We are currently unable to make reasonably reliable estimates of the period of cash settlement with the taxing authorities for our remaining $27.3 million of reserves for uncertain tax positions.

Other Considerations

We have no current plans to pay any cash dividends on our common stock and instead may retain earnings, if any, for future operation and expansion and debt repayment. Any decision to declare and pay dividends in the future will be made at the discretion of our Board of Directors, subject to certain limitations found in covenants in our Credit Facilities and in the indentures governing the Notes as discussed in more detail above, and will depend on, among other things, our results of operations, cash requirements, financial condition, contractual restrictions and other factors that our Board of Directors may deem relevant.

Our inventory balance represented approximately 45% of our total assets exclusive of goodwill and other intangible assets as of January 28, 2011. Our proficiency in managing our inventory balances can have a significant impact on our cash flows from operations during a given fiscal year. As a result, efficient inventory management has been and continues to be an area of focus for us.

As described in Note 9 to the Consolidated Financial Statements, we are involved in a number of legal actions and claims, some of which could potentially result in material cash payments. Adverse developments in those actions could materially and adversely affect our liquidity. As discussed in Note 6 to the Consolidated Financial Statements, we also have certain income tax-related contingencies. Future negative developments could have a material adverse effect on our liquidity.

In June 2010, Standard & Poor s upgraded our long-term debt rating to BB from BB- with a stable outlook and in November 2010, Moody s upgraded our long-term debt rating to Ba3 from B1 with a positive outlook. These current ratings are considered non-investment grade. Our current credit ratings, as well as future rating agency actions, could (i) impact our ability to obtain financings to finance our operations on satisfactory terms; (ii) affect our financing costs; and (iii) affect our insurance premiums and collateral requirements necessary for our self-insured programs.

Cash flows

Cash flows from operating activities.

A significant component of our increase in cash flows from operating activities in 2010 compared to 2009 was the increase in net income due to greater sales, higher gross margins and lower SG&A expenses as a percentage of sales, as described in more detail above under Results of Operations. Partially offsetting this increase in cash flows were changes in inventory balances, which increased by 16% in 2010 compared to an increase of 7% in 2009. Although we continue to closely monitor our inventory balances, they often fluctuate from period to period and from year to year based on new store openings, the timing of purchases, merchandising initiatives and other factors. Inventory levels in the consumables category increased by $133.9 million, or 16%, in 2010 compared to an increase of $111.4 million, or 15%, in 2009. The seasonal category increased by $55.2 million, or 18%, in 2010 compared to an increase of $25.3 million, or 9%, in 2009. The home products category increased $25.2 million, or 17%, in 2010 compared to a decline of $9.1 million, or 6%, in 2009. The apparel category increased by $32.3 million, or 15%, in 2010 compared to a decline of $22.9 million, or 10%, in 2009. In addition, increased net income resulted in an increase in income taxes paid in 2010 compared to 2009. Changes in Accrued expenses and other were affected in part by reductions of income tax reserves and reduced accruals for incentive compensation, partially offset by the timing of payments related to a litigation settlement in prior years (as discussed in more detail below) and by lower accruals for interest on long-term debt.

Our increase in cash flows from operating activities in 2009 compared to 2008 was also driven by an increase in net income due to greater sales, higher gross margins and lower SG&A expenses as a percentage of sales. In addition, we experienced increased inventory turns in 2009 as compared to 2008. Changes in inventory balances increased by 7% in 2009 compared to an increase of 10% in 2008. Inventory levels in the consumables category increased by $111.4

million, or 15%, in 2009 compared to an increase of $77.8 million, or 12%, in 2008. The seasonal category increased by $25.3 million, or 9%, in 2009 compared to an increase of $20.9 million, or 8%, in 2008. The home products category declined $9.1 million, or 6%, in 2009 compared to a decline of $2.6 million, or 2%, in 2008. The apparel category declined by $22.9 million, or 10%, in 2009 compared to an increase of $30.2 million, or 15%, in 2008. In addition, increased net income in 2009 compared to 2008 was a principal factor in the increase in income taxes paid in 2009 compared to 2008. Changes in Accrued expenses and other were affected in part by the timing of the payments related to the Litigation settlement and related costs discussed above under Results of Operations, as the associated insurance proceeds of $10.0 million were received at the end of 2008 while the payment of the $40.0 million settlement occurred at the beginning of 2009.

Cash flows from investing activities. Cash flows used in investing activities totaling $418.9 million in 2010 were primarily related to capital expenditures. Significant components of our property and equipment purchases in 2010 included the following approximate amounts: $156 million for improvements, upgrades, remodels and relocations of existing stores; $100 million for new leased stores; $91 million for stores purchased or built by us; $45 million for distribution and transportation-related capital expenditures; and $22 million for information systems upgrades and technology-related projects. During 2010 we opened 600 new stores and remodeled or relocated 504 stores.

Cash flows used in investing activities totaling $248.0 million in 2009 were also primarily related to capital expenditures. Significant components of our property and equipment purchases in 2009 included the following approximate amounts: $114 million for improvements, upgrades, remodels and relocations of existing stores; $69 million for new leased stores; $28 million for distribution and transportation-related capital expenditures; $24 million for various administrative capital costs; and $11 million for information systems upgrades and technology-related projects. During 2009 we opened 500 new stores and remodeled or relocated 450 stores.

Cash flows used in investing activities totaling $152.6 million in 2008 were primarily related to capital expenditures, offset by sales of investments. Significant components of our property and equipment purchases in 2008 included the following approximate amounts: $149 million for improvements, upgrades, remodels and relocations of existing stores; $22 million for new leased stores; $17 million for distribution and transportation-related capital expenditures; and $13 million for information systems upgrades and technology-related projects. During 2008 we opened 207 new stores and remodeled or relocated 404 stores.

Purchases and sales of short-term investments equal to net sales of $51.6 million in 2008 primarily reflected investment activities in our captive insurance subsidiary.

Capital expenditures during 2011 are projected to be in the range of $550-$600 million. We anticipate funding 2011 capital requirements with cash flows from operations, and if necessary, we also have significant availability under our ABL Facility. Significant components of the 2011 capital plan include growth initiatives, such as approximately 625 new stores including the purchase of existing stores and the construction of new stores; costs related to new leased stores including leasehold improvements, fixtures and equipment; continued investment in our existing store base with plans for remodeling and relocating approximately 550 stores; the construction of a new distribution center in Alabama; as well as additional investments in our supply chain and information technology. We plan to undertake these expenditures as part of our efforts to improve our infrastructure and increase our cash generated from operating activities.

Cash flows from financing activities. During 2010, we repurchased $115.0 million outstanding principal amount of our outstanding Senior Notes at a total cost of $127.5 million including associated premiums. We had no borrowings or repayments under the ABL Facility in 2010.

In 2009, we had cash inflows from the issuance of equity of $443.8 million primarily due to our initial public offering of 22.7 million shares of common stock. We used the proceeds from the offering to redeem outstanding Notes with a total principal amount of $400.9 million at a premium, and used cash generated from operations to repay $336.5 million outstanding principal amount on our Term Loan Facility. We had no borrowings or repayments under the ABL Facility in 2009. In addition, we paid a dividend and related amounts totaling $239.7 million using cash generated from operations.

In February 2008, we repaid outstanding borrowings of $102.5 million under our ABL Facility, and have had no borrowings outstanding under the ABL facility since that time. Also during 2008, we repurchased $44.1 million principal amount of our outstanding Senior Subordinated Notes.

Critical Accounting Policies and Estimates

The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect reported amounts and related disclosures. In addition to the estimates presented below, there are other items within our financial statements that require estimation, but are not deemed critical as defined below. We believe these estimates are reasonable and appropriate. However, if actual experience differs from the assumptions and other considerations used, the resulting changes could have a material effect on the financial statements taken as a whole.

Management believes the following policies and estimates are critical because they involve significant judgments, assumptions, and estimates. Management has discussed the development and selection of the critical accounting estimates with the Audit Committee of our Board of Directors, and the Audit Committee has reviewed the disclosures presented below relating to those policies and estimates.

Merchandise Inventories. Merchandise inventories are stated at the lower of cost or market with cost determined using the retail last-in, first-out (LIFO) method. Under our retail inventory method (RIM), the calculation of gross profit and the resulting valuation of inventories at cost are computed by applying a calculated cost-to-retail inventory ratio to the retail value of sales at a department level. The RIM is an averaging method that has been widely used in the retail industry due to its practicality. Also, it is recognized that the use of the RIM will result in valuing inventories at the lower of cost or market (LCM) if markdowns are currently taken as a reduction of the retail value of inventories.

Inherent in the RIM calculation are certain significant management judgments and estimates including, among others, initial markups, markdowns, and shrinkage, which significantly impact the gross profit calculation as well as the ending inventory valuation at cost. These significant estimates, coupled with the fact that the RIM is an averaging process, can, under certain circumstances, produce distorted cost figures. Factors that can lead to distortion in the calculation of the inventory balance include:

- applying the RIM to a group of products that is not fairly uniform in terms of its cost and selling price relationship and turnover;

- applying the RIM to transactions over a period of time that include different rates of gross profit, such as those relating to seasonal merchandise;

- inaccurate estimates of inventory shrinkage between the date of the last physical inventory at a store and the financial statement date; and

- inaccurate estimates of LCM and/or LIFO reserves.

Factors that reduce potential distortion include the use of historical experience in estimating the shrink provision (see discussion below) and an annual LIFO analysis whereby all SKUs are considered in the index formulation. An actual valuation of inventory under the LIFO method is made at the end of each year based on the inventory levels and costs at that time. Accordingly, interim LIFO calculations are based on management s estimates of expected year-end inventory levels, sales for the year and the expected rate of inflation/deflation for the year and are thus subject to adjustment in the final year-end LIFO inventory valuation. We also perform interim inventory analysis for determining obsolete inventory. Our policy is to write down inventory to an LCM value based on various management assumptions including estimated markdowns and sales required to liquidate such inventory in future periods. Inventory is reviewed on a quarterly basis and adjusted as appropriate to reflect write-downs determined to be necessary.

Factors such as slower inventory turnover due to changes in competitors practices, consumer preferences, consumer spending and unseasonable weather patterns, among other factors, could cause excess inventory requiring greater than estimated markdowns to entice consumer purchases, resulting in an unfavorable impact on our consolidated financial statements. Sales shortfalls due to the above factors could cause reduced purchases from vendors and associated vendor allowances that would also result in an unfavorable impact on our consolidated financial statements.

We calculate our shrink provision based on actual physical inventory results during the fiscal period and an accrual for estimated shrink occurring subsequent to a physical inventory through the end of the fiscal reporting period. This accrual is calculated as a percentage of sales at each retail store, at a department level, and is determined by dividing the book-to-physical inventory adjustments recorded during the previous twelve months by the related sales for the same period for each store. To the extent that subsequent physical inventories yield different results than this estimated accrual, our effective shrink rate for a given reporting period will include the impact of adjusting the estimated results to the actual results. Although we perform physical inventories in virtually all of our stores on an annual basis, the same stores do not necessarily get counted in the same reporting periods from year to year, which could impact comparability in a given reporting period.

We believe our estimates and assumptions related to merchandise inventories have generally been accurate in recent years and we do not currently anticipate material changes in these estimates and assumptions.

Goodwill and Other Intangible Assets. We amortize intangible assets over their estimated useful lives unless such lives are deemed indefinite. If impairment indicators are noted, amortizable intangible assets are tested for impairment based on projected undiscounted cash flows, and, if impaired, written down to fair value based on either discounted projected cash flows or appraised values. Future cash flow projections are based on management s projections. Significant judgments required in this testing process may include projecting future cash flows, determining appropriate discount rates and other assumptions. Projections are based on management s best estimates given recent financial performance, market trends, strategic plans and other available information which in recent years have been materially accurate. Although not currently anticipated, changes in these estimates and assumptions could materially affect the determination of fair value or impairment. Future indicators of impairment could result in an asset impairment charge.

Under accounting standards for goodwill and other intangible assets, we are required to test such assets with indefinite lives for impairment annually, or more frequently if impairment indicators occur. The goodwill impairment test is a two-step process that requires management to make judgments in determining what assumptions to use in the calculation. The first step of the process consists of estimating the fair value of our reporting unit based on valuation techniques (including a discounted cash flow model using revenue and profit forecasts) and comparing that estimated fair value with the recorded carrying value, which includes goodwill. If the estimated fair value is less than the carrying value, a second step is performed to compute the amount of the impairment by determining an implied fair value of goodwill. The determination of the implied fair value of goodwill would require us to allocate the estimated fair value of our reporting unit to its assets and liabilities. Any unallocated fair value represents the implied fair value of goodwill, which would be compared to its corresponding carrying value.

The impairment test for indefinite-lived intangible assets consists of a comparison of the fair value of the intangible asset with its carrying amount. If the carrying amount of an indefinite-lived intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess.

We performed our annual impairment tests of goodwill and indefinite-lived intangible assets during the third quarter of 2010 based on conditions as of the end of the second quarter of 2010. The tests indicated that no impairment charge was necessary. We are not currently projecting a decline in cash flows that could be expected to have an adverse effect such as a violation of debt covenants or future impairment charges.

Property and Equipment. Property and equipment are recorded at cost. We group our assets into relatively homogeneous classes and generally provide for depreciation on a straight-line basis over the estimated average useful life of each asset class, except for leasehold improvements, which are amortized over the lesser of the applicable lease term or the estimated useful life of the asset. Certain store and warehouse fixtures, when fully depreciated, are removed from the cost and related accumulated depreciation and amortization accounts. The valuation and classification of these assets and the assignment of depreciable lives involves significant judgments and the use of estimates, which we believe have been materially accurate in recent years.

Impairment of Long-lived Assets. We review the carrying value of all long-lived assets for impairment at least annually, and whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. In accordance with accounting standards for impairment or disposal of long-lived assets, we review for impairment stores open for approximately two years or more for which recent cash flows from operations are negative. Impairment results when the carrying value of the assets exceeds the estimated undiscounted future cash flows over the life of the lease. Our estimate of undiscounted future cash flows over the lease term is based upon historical operations of the stores and estimates of future store profitability which encompasses many factors that are subject to variability and are difficult to predict. If a long-lived asset is found to be impaired, the amount recognized for impairment is equal to the difference between the carrying value and the asset s estimated fair value. The fair value is estimated based primarily upon projected future cash flows (discounted at our credit adjusted risk-free rate) or other reasonable estimates of fair market value in accordance with U.S. GAAP. During 2010, 2009 and 2008 we recorded pre-tax impairment charges of $1.7 million, $5.0 million and $4.0 million, respectively, for certain store assets that we deemed to be impaired.

Insurance Liabilities. We retain a significant portion of the risk for our workers compensation, employee health, property loss, automobile and general liability. These represent significant costs primarily due to the large employee base and number of stores. Provisions are made to these liabilities on an undiscounted basis based on actual claim data and estimates of incurred but not reported claims developed using actuarial methodologies based on historical claim trends, which have been and are anticipated to continue to be materially accurate. If future claim trends deviate from recent historical patterns, we may be required to record additional expenses or expense reductions, which could be material to our future financial results.

Contingent Liabilities Income Taxes. Income tax reserves are determined using the methodology established by accounting standards relating to uncertainty in income taxes. These standards require companies to assess each income tax position taken using a two step process. A determination is first made as to whether it is more likely than not that the position will be sustained, based upon the technical merits, upon examination by the taxing authorities. If the tax position is expected to meet the more likely than not criteria, the benefit recorded for the tax position equals the largest amount that is greater than 50% likely to be realized upon ultimate settlement of the respective tax position. Uncertain tax positions require determinations and estimated liabilities to be made based on provisions of the tax law which may be subject to

change or varying interpretation. If our determinations and estimates prove to be inaccurate, the resulting adjustments could be material to our future financial results.

Contingent Liabilities - Legal Matters. We are subject to legal, regulatory and other proceedings and claims. We establish liabilities as appropriate for these claims and proceedings based upon the probability and estimability of losses and to fairly present, in conjunction with the disclosures of these matters in our financial statements and SEC filings, management s view of our exposure. We review outstanding claims and proceedings with external counsel to assess probability and estimates of loss. We re-evaluate these assessments on a quarterly basis or as new and significant information becomes available to determine whether a liability should be established or if any existing liability should be adjusted. The actual cost of resolving a claim or proceeding ultimately may be substantially different than the amount of the recorded liability. In addition, because it is not permissible under U.S. GAAP to establish a litigation liability until the loss is both probable and estimable, in some cases there may be insufficient time to establish a liability prior to the actual incurrence of the loss (upon verdict and judgment at trial, for example, or in the case of a quickly negotiated settlement).

Lease Accounting and Excess Facilities. Many of our stores are subject to build-to-suit arrangements with landlords, which typically carry a primary lease term of 10-15 years with multiple renewal options. We also have stores subject to shorter-term leases (usually with initial or current terms of 3 to 5 years), and many of these leases have multiple renewal options. As of January 28, 2011, approximately 35% of our stores had provisions for contingent rentals based upon a percentage of defined sales volume. We recognize contingent rental expense when the achievement of specified sales targets is considered probable. We recognize rent expense over the term of the lease. We record minimum rental expense on a straight-line basis over the base, non-cancelable lease term commencing on the date that we take physical possession of the property from the landlord, which normally includes a period prior to store opening to make necessary leasehold improvements and install store fixtures. When a lease contains a predetermined fixed escalation of the minimum rent, we recognize the related rent expense on a straight-line basis and record the difference between the recognized rental expense and the amounts payable under the lease as deferred rent. Tenant allowances, to the extent received, are recorded as deferred incentive rent and amortized as a reduction to rent expense over the term of the lease. We reflect as a liability any difference between the calculated expense and the amounts actually paid. Improvements of leased properties are amortized over the shorter of the life of the applicable lease term or the estimated useful life of the asset.

For store closures (excluding those associated with a business combination) where a lease obligation still exists, we record the estimated future liability associated with the rental obligation on the date the store is closed in accordance with accounting standards for costs associated with exit or disposal activities. Based on an overall analysis of store performance and expected trends, management periodically evaluates the need to close underperforming stores. Liabilities are established at the point of closure for the present value of any remaining operating lease obligations, net of estimated sublease income, and at the communication date for severance and other exit costs. Key assumptions in calculating the liability include the timeframe expected to terminate lease agreements, estimates related to the sublease potential of closed locations, and estimation of other related exit costs. Historically, these estimates have not been materially inaccurate; however, if actual timing and potential termination costs or realization of sublease

income differ from our estimates, the resulting liabilities could vary from recorded amounts. These liabilities are reviewed periodically and adjusted when necessary.

Share-Based Payments. Our share-based stock option awards are valued on an individual grant basis using the Black-Scholes-Merton closed form option pricing model. We believe that this model fairly estimates the value of our share-based awards. The application of this valuation model involves assumptions that are judgmental and highly sensitive in the valuation of stock options, which affects compensation expense related to these options. These assumptions include an estimate of the fair value of our common stock, the term that the options are expected to be outstanding, an estimate of the volatility of our stock price (which is based on a peer group of publicly traded companies), applicable interest rates and the dividend yield of our stock. Our volatility estimates are based on a peer group due to the fact that our stock has been publicly traded for a relatively short period of time in relation to the expected term of outstanding options. Other factors involving judgments that affect the expensing of share-based payments include estimated forfeiture rates of share-based awards. Historically, these estimates have not been materially inaccurate; however, if our estimates differ materially from actual experience, we may be required to record additional expense or reductions of expense, which could be material to our future financial results.

Fair Value Measurements. We measure fair value of assets and liabilities in accordance with applicable accounting standards, which require that fair values be determined based on the assumptions that market participants would use in pricing the asset or liability. These standards establish a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity s own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy). Therefore, Level 3 inputs are typically based on an entity s own assumptions, as there is little, if any, related market activity, and thus require the use of significant judgment and estimates. Currently, we have no assets or liabilities that are valued based solely on Level 3 inputs.

Our fair value measurements are primarily associated with our derivative financial instruments, intangible assets, property and equipment, and to a lesser degree our investments. The values of our derivative financial instruments are determined using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves. The fair values of interest rate swaps are determined using the market standard methodology of netting the discounted future fixed cash payments (or receipts) and the discounted expected variable cash receipts (or payments). The variable cash receipts (or payments) are based on an expectation of future interest rates (forward curves) derived from observable market interest rate curves. In recent years, these methodologies have produced materially accurate valuations.

Derivative Financial Instruments. We account for our derivative instruments in accordance with accounting standards for derivative instruments (including certain derivative instruments embedded in other contracts) and hedging activities, as amended and interpreted,

which establish accounting and reporting requirements for such instruments and activities. These standards require that every derivative instrument be recorded in the balance sheet as either an asset or liability measured at its fair value, and that changes in the derivative s fair value be recognized currently in earnings unless specific hedge accounting criteria are met. See Fair Value Measurements above for a discussion of derivative valuations. Special accounting for qualifying hedges allows a derivative s gains and losses to either offset related results on the hedged item in the statement of operations or be accumulated in other comprehensive income, and requires that a company formally document, designate, and assess the effectiveness of transactions that receive hedge accounting. We use derivative instruments to manage our exposure to changing interest rates, primarily with interest rate swaps.

In addition to making valuation estimates, we also bear the risk that certain derivative instruments that have been designated as hedges and currently meet the strict hedge accounting requirements may not qualify in the future as highly effective, as defined, as well as the risk that hedged transactions in cash flow hedging relationships may no longer be considered probable to occur. Further, new interpretations and guidance related to these instruments may be issued in the future, and we cannot predict the possible impact that such guidance may have on our use of derivative instruments going forward.

ITEM 7A.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Financial Risk Management

We are exposed to market risk primarily from adverse changes in interest rates, and to a lesser degree commodity prices. To minimize this risk, we may periodically use financial instruments, including derivatives. As a matter of policy, we do not buy or sell financial instruments for speculative or trading purposes and all derivative financial instrument transactions must be authorized and executed pursuant to approval by the Board of Directors. All financial instrument positions taken by us are intended to be used to reduce risk by hedging an underlying economic exposure. Because of high correlation between the derivative financial instrument and the underlying exposure being hedged, fluctuations in the value of the financial instruments are generally offset by reciprocal changes in the value of the underlying economic exposure.

Interest Rate Risk

We manage our interest rate risk through the strategic use of fixed and variable interest rate debt and, from time to time, derivative financial instruments. Our principal interest rate exposure relates to outstanding amounts under our Credit Facilities. As of January 28, 2011, our Credit Facilities provide for variable rate borrowings of up to $2.995 billion including availability of up to $1.031 billion under our ABL Facility, subject to the borrowing base. In order to mitigate a portion of the variable rate interest exposure under the Credit Facilities, we entered into certain interest rate swaps which became effective on July 31, 2007. Pursuant to these swaps, we swapped three month LIBOR rates for fixed interest rates, resulting in the payment of an all-in fixed rate of 7.68% on an original notional amount of $2.0 billion originally scheduled to amortize on a quarterly basis until maturity at July 31, 2012.

In October 2008, a counterparty to one of our 2007 swap agreements defaulted. We terminated this agreement and in November 2008 we subsequently cash settled the swap. Representatives of the counterparty have challenged our calculation of the cash settlement. See Legal Proceedings under Note 9 of the footnotes to the consolidated financial statements. As of January 28, 2011, the notional amount under the remaining 2007 swaps is $646.7 million.

Effective December 31, 2008, we entered into a $475.0 million interest rate swap in order to mitigate an additional portion of the variable rate interest exposure under the Credit Facilities. This swap is scheduled to mature on January 31, 2013. Under the terms of this agreement we swapped one month LIBOR rates for fixed interest rates, resulting in the payment of a fixed rate of 5.06% on a notional amount of $475.0 million through April 2010, $400.0 million from May 2010 through October 2011, and $300.0 million to maturity.

A change in interest rates on variable rate debt impacts our pre-tax earnings and cash flows; whereas a change in interest rates on fixed rate debt impacts the economic fair value of debt but not our pre-tax earnings and cash flows. Our interest rate swaps qualify for hedge accounting as cash flow hedges. Therefore, changes in market fluctuations related to the

effective portion of these cash flow hedges do not impact our pre-tax earnings until the accrued interest is recognized on the derivatives and the associated hedged debt. Based on our variable rate borrowing levels and interest rate swaps outstanding during 2010 and 2009, the annualized effect of a one percentage point change in variable interest rates would have resulted in a pretax reduction of our earnings and cash flows of approximately $9.3 million in 2010 and $5.6 million in 2009.

The conditions and uncertainties in the global credit markets have increased the credit risk of other counterparties to our swap agreements. In the event such counterparties fail to perform under our swap agreements and we are unable to enter into new swap agreements on terms favorable to us, our ability to effectively manage our interest rate risk may be materially impaired. We attempt to manage counterparty credit risk by periodically evaluating the financial position and creditworthiness of such counterparties, monitoring the amount for which we are at risk with each counterparty, and where possible, dispersing the risk among multiple counterparties. There can be no assurance that we will manage or mitigate our counterparty credit risk effectively.

ITEM 8.

FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of

Dollar General Corporation

We have audited the accompanying consolidated balance sheets of Dollar General Corporation and subsidiaries as of January 28, 2011 and January 29, 2010, and the related consolidated statements of income, shareholders' equity, and cash flows for the years ended January 28, 2011, January 29, 2010 and January 30, 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 Dollar General Corporation and subsidiaries at January 28, 2011 and January 29, 2010, and the consolidated results of their operations and their cash flows for the years ended January 28, 2011, January 29, 2010 and January 30, 2009, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Dollar General Corporation's internal control over financial reporting as of January 28, 2011, 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 22, 2011 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Nashville, Tennessee

March 22, 2011

DOLLAR GENERAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands, except per share amounts)

	January 28, 2011		January 29, 2010	
ASSETS				
Current assets:				
Cash and cash equivalents	$	497,446	$	

222,076

Merchandise inventories

1,765,433

1,519,578

Income taxes receivable

-

7,543

Prepaid expenses and other current assets

104,946

96,252

Total current assets

2,367,825

1,845,449

Net property and equipment

1,524,575

1,328,386

Goodwill

4,338,589

4,338,589

Intangible assets, net

1,256,922

1,284,283

Other assets, net

58,311

66,812

Total assets	$ 9,546,222	$ 8,863,519

LIABILITIES AND SHAREHOLDERS EQUITY

Current liabilities:

Current portion of long-term obligations	$ 1,157	$ 3,671
Accounts payable	953,641	830,953
Accrued expenses and other	347,741	342,290
Income taxes payable	25,980	4,525

Deferred income taxes payable	36,854	25,061
Total current liabilities	1,365,373	1,206,500
Long-term obligations	3,287,070	3,399,715
Deferred income taxes payable	598,565	546,172

Other liabilities

231,582

302,348

Commitments and contingencies

Redeemable common stock

9,153

18,486

Shareholders equity:

Preferred stock, 1,000 shares authorized

-

-

Common stock; $0.875 par value, 1,000,000 shares authorized, 341,507 and 340,586 shares issued and outstanding at

January 28, 2011 and January 29, 2010, respectively

298,819

298,013

Additional paid-in capital

2,945,024

2,923,377

Retained earnings

830,932

203,075

Accumulated other comprehensive loss

(20,296)

	(34,167)
Total shareholders equity	4,054,479
	3,390,298
Total liabilities and shareholders equity	$ 9,546,222
	$ 8,863,519

The accompanying notes are an integral part of the consolidated financial statements.

DOLLAR GENERAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share amounts)

	For the Year Ended January 28, 2011	January 29, 2010	January 30, 2009
Net sales	$ 13,035,000	$	

11,796,380

$

10,457,668

Cost of goods sold

8,858,444

8,106,509

7,396,571

Gross profit

4,176,556

3,689,871

3,061,097

Selling, general and administrative expenses

2,902,491

2,736,613

2,448,611

Litigation settlement and related costs, net

-

-

32,000

Operating profit

1,274,065

953,258

580,486

Interest income

(220)

(144)

(3,061)

Interest expense

274,212

345,744

391,932

Other (income) expense

15,101

55,542

(2,788)

Income before income taxes

984,972

552,116

194,403

Income tax expense

357,115

212,674

86,221

Net income

$

627,857

$

339,442

$

108,182

Earnings per share:

Basic

$
1.84

$
1.05

$
0.34

Diluted

$
1.82

$
1.04

$
0.34

Weighted average shares:			
Basic	341,047	322,778	317,024
Diluted	344,800	324,836	

317,503

The accompanying notes are an integral part of the consolidated financial statements.

DOLLAR GENERAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

(In thousands except per share amounts)

	Common Stock Shares		Common Stock		Additional Paid-in Capital		Retained Earnings (Accumulated Deficit)		Accumulated Other Comprehensive Loss	Total
Balances, February 1, 2008	317,418	$	277,741	$	2,480,062	$	(4,818)	$		

(49,112)

$

2,703,873

Comprehensive income:

Net income

-

-

-

108,182

-

108,182

Unrealized net gain on hedged transactions, net of income tax expense of $4,518

-

-

-

-

9,682

9,682

Comprehensive income

117,864

Issuance of common stock under stock incentive plans

484

423

(423)

-

-

-

Repurchases of common stock

(57)

(50)

50

-

-

-

Share-based compensation expense

-

-

9,958

-

-

9,958

Balances, January 30, 2009

317,845

$

278,114

$

2,489,647

$

103,364

$

(39,430)

$

2,831,695

Comprehensive income:

Net income

-

-

-

339,442

-

339,442

Unrealized net gain on hedged transactions, net of income tax expense of $2,553

-

-

-

-

5,263

5,263

Comprehensive income

344,705

Issuance of common stock

22,700

19,863

421,299

-

-

441,162

Cash dividends, $0.7525 per common share, and related amounts

-

-

-

(239,731)

	-
	(239,731)
Share-based compensation expense	
	-
	-
	15,009
	-
	-
	15,009
Tax benefit from stock option exercises	
	-
	-
	3,072

-

-

3,072

Issuance of common stock under stock incentive plans

304

266

2,020

-

-

2,286

Equity settlements under stock incentive plans

(263)

(230)

(7,670)

-

-

(7,900)

Balances, January 29, 2010

340,586

$

298,013

$

2,923,377

$

203,075

$

(34,167)

$

3,390,298

Comprehensive income:

Net income	
	-
	-
	-
	627,857
	-
	627,857
Unrealized net gain on hedged transactions, net of income tax expense of $9,406	
	-
	-

-

-

13,871

13,871

Comprehensive income

641,728

Share-based compensation expense

-

-

12,805

-

-

12,805

Tax benefit from stock option exercises

-

-

10,110

-

-

10,110

Issuance of common stock under stock incentive plans

93

82

1,943
-
-
2,025
Exercise of stock options
872
763
(8,399)
-
-
(7,636)
Other equity settlements under stock incentive plans
(44)
(39)

5,188

-

-

5,149

Balances, January 28, 2011

341,507

$

298,819

$

2,945,024

$

830,932

$

(20,296)

$

4,054,479

The accompanying notes are an integral part of the consolidated financial statements.

DOLLAR GENERAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

For the Year Ended

January 28,

2011

January 29, 2010

January 30,

2009

Cash flows from operating activities:

Net income

$

627,857

$

339,442

$

108,182

Adjustments to reconcile net income to net cash provided by operating activities:

Depreciation and amortization

254,927

256,771

	247,899
Deferred income taxes	
	50,985
	14,860
	73,434
Tax benefit of stock options	
	(13,905)
	(5,390)
	(950)
Loss (gain) on debt retirement	
	14,576

55,265

(3,818)

Noncash share-based compensation

15,956

17,295

9,958

Noncash inventory adjustments and asset impairments

7,607

647

50,671

Other noncash gains and losses

5,942

7,920

6,252

Change in operating assets and liabilities:

Merchandise inventories

(251,809)

(100,248)

(173,014)

Prepaid expenses and other current assets

(10,157)

(7,298)

(598)

Accounts payable

123,424

106,049

140,356

Accrued expenses and other liabilities	
	(42,428)
	(12,643)
	68,736
Income taxes	
	42,903
	1,153
	33,986
Other	
	(1,194)
	(1,000)

14,084

Net cash provided by operating activities

824,684

672,823

575,178

Cash flows from investing activities:

Purchases of property and

equipment	
	(420,395)
	(250,747)
	(205,546)
Purchases of short-term investments	
	-
	-
	(9,903)
Sales of short-term investments	
	-
	-

61,547

Sales of property and equipment

1,448

2,701

1,266

Net cash used in investing activities

(418,947)

(248,046)

(152,636)

Cash flows from financing

activities:

Issuance of common stock

631

443,753

4,228

Repayments under revolving credit facility

-

-

(102,500)

Issuance of long-term obligations

-

1,080

-

Repayments of long-term obligations

(131,180)

(785,260)

(44,425)

Payment of cash dividends and related amounts

-

(239,731)

-

Repurchases of common stock and settlement of equity awards, net of employee taxes paid

(13,723)

(5,928)

(3,009)

Tax benefit of stock options

13,905

5,390

950

Net cash used in financing activities

(130,367)

(580,696)

(144,756)

Net increase (decrease) in cash and cash equivalents

275,370

(155,919)

277,786

Cash and cash equivalents, beginning of year	222,076	377,995	100,209
Cash and cash equivalents, end of year	$ 497,446	$ 222,076	$ 377,995

Supplemental cash flow information:

Cash paid for:

Interest

$

244,752

$

328,433

$

377,022

Income taxes

314,123

187,983

7,091

Supplemental schedule of noncash investing and financing *activities:*

Purchases of property and equipment awaiting processing for payment, included in Accounts payable	$ 29,658	$ 30,393	$ 7,474
Purchases of property and equipment under capital lease obligations			

-

50

3,806

Expiration of equity repurchase rights

-

-

2,548

The accompanying notes are an integral part of the consolidated financial statements.

DOLLAR GENERAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1.

Basis of presentation and accounting policies

Basis of presentation

These notes contain references to the years 2010, 2009 and 2008, which represent fiscal years ended January 28, 2011, January 29, 2010 and January 30, 2009, respectively, each of which were 52-week accounting periods. The Company s fiscal year ends on the Friday closest to January 31. The consolidated financial statements include all subsidiaries of the Company, except for its not-for-profit subsidiary which the Company does not control. Intercompany transactions have been eliminated.

Business description

The Company sells general merchandise on a retail basis through 9,372 stores (as of January 28, 2011) in 35 states covering most of the southern, southwestern, midwestern and eastern United States. The Company has distribution centers (DCs) in Scottsville, Kentucky; Ardmore, Oklahoma; South Boston, Virginia; Indianola, Mississippi; Fulton, Missouri; Alachua, Florida; Zanesville, Ohio; Jonesville, South Carolina and Marion, Indiana.

The Company purchases its merchandise from a wide variety of suppliers. Approximately 9% and 7% of the Company s purchases in 2010 were made from the Company s largest and second largest suppliers, respectively.

Cash and cash equivalents

Cash and cash equivalents include highly liquid investments with insignificant interest rate risk and original maturities of three months or less when purchased. Such investments primarily consist of money market funds, bank deposits, certificates of deposit (which may include foreign time deposits), and commercial paper. The carrying amounts of these items are a reasonable estimate of their fair value due to the short maturity of these investments.

Payments due from processors for electronic tender transactions classified as cash and cash equivalents totaled approximately $26.1 million and $23.2 million at January 28, 2011 and January 29, 2010, respectively.

The Company s cash management system provides for daily investment of available balances and the funding of outstanding checks when presented for payment. Outstanding but unpresented checks totaling approximately $153.6 million and $159.6 million at January 28, 2011 and January 29, 2010, respectively, have been included in Accounts payable in the consolidated balance sheets. Upon presentation for payment, these checks are funded through available cash balances or the Company s credit facilities.

At January 28, 2011, the Company maintained cash balances to meet a $20 million minimum threshold set by insurance regulators, as further described below under Insurance liabilities.

Investments in debt and equity securities

The Company accounts for its investments in debt and marketable equity securities as held-to-maturity, available-for-sale, or trading, depending on their classification. Debt securities categorized as held-to-maturity are stated at amortized cost. Debt and equity securities categorized as available-for-sale are stated at fair value, with any unrealized gains and losses, net of deferred income taxes, reported as a component of Accumulated other comprehensive loss. Trading securities (primarily mutual funds held pursuant to deferred compensation and supplemental retirement plans, as further discussed in Note 10) are stated at fair value, with changes in fair value recorded as a component of Selling, general and administrative (SG&A) expense.

As of January 28, 2011 and January 29, 2010, the Company had investments in trading securities of $8.3 million and $8.8 million, respectively, $2.2 million and $1.6 million of which were classified as Prepaid expenses and other current assets, respectively, and $6.1 million and $7.2 million of which were classified as Other assets, net, respectively, in the consolidated balance sheets. Historical cost information pertaining to these investments in mutual funds by participants in the Company s supplemental retirement and compensation deferral plans is not readily available to the Company.

During 2008, the Company s South Carolina-based wholly owned captive insurance subsidiary, Ashley River Insurance Company (ARIC), had investments in various debt securities. These investments were held pursuant to South Carolina regulatory requirements to maintain certain asset balances related to ARIC s liability and equity balances, which could have limited the Company s ability to use these assets for general corporate purposes. In May 2008, the state of South Carolina made certain changes to these regulations, which in turn changed the Company s investment requirements. As a result, the Company reclassified certain investments held by ARIC from held-to-maturity to available-for-sale, and ARIC subsequently liquidated certain investments totaling $48.6 million during 2008.

For the years ended January 28, 2011, January 29, 2010 and January 30, 2009, gross realized gains and losses on the sales of available-for-sale securities were not material. The cost of securities sold is based upon the specific identification method.

Merchandise inventories

Inventories are stated at the lower of cost or market with cost determined using the retail last-in, first-out (LIFO) method as this method results in a better matching of costs and revenues. Under the Company s retail inventory method (RIM), the calculation of gross profit and the resulting valuation of inventories at cost are computed by applying a calculated cost-to-retail inventory ratio to the retail value of sales at a department level. Costs directly associated with warehousing and distribution are capitalized into inventory. The excess of current cost over LIFO cost was approximately $52.8 million and $47.5 million at January 28, 2011 and January

29, 2010, respectively. Current cost is determined using the RIM on a first-in, first-out basis. Under the LIFO inventory method, the impacts of rising or falling market price changes increase or decrease cost of sales (the LIFO provision or benefit). The Company recorded a LIFO provision of $5.3 million in 2010, a LIFO benefit of $2.5 million in 2009, and a LIFO provision of $43.9 million in 2008.

The 2008 LIFO provision was impacted by increased commodity costs related to food and pet products which were driven by fruit and vegetable prices and rising freight costs. In addition, increases in petroleum, resin, metals, pulp and other raw material commodity costs also resulted in multiple product cost increases. These trends generally stabilized or reversed in 2009 and 2010.

Vendor rebates

The Company accounts for all cash consideration received from vendors in accordance with applicable accounting standards pertaining to such arrangements. Cash consideration received from a vendor is generally presumed to be a rebate or an allowance and is accounted for as a reduction of merchandise purchase costs as earned. However, certain specific, incremental and otherwise qualifying SG&A expenses related to the promotion or sale of vendor products may be offset by cash consideration received from vendors, in accordance with arrangements such as cooperative advertising, when earned for dollar amounts up to but not exceeding actual incremental costs. The Company recognizes amounts received for cooperative advertising on performance, first showing or distribution, consistent with its policy for advertising expense in accordance with applicable accounting standards for reporting on advertising costs.

Prepaid expenses and other current assets

Prepaid expenses and other current assets include prepaid amounts for rent, maintenance, advertising, and insurance, as well as amounts receivable for certain vendor rebates (primarily those expected to be collected in cash), coupons, and other items.

Property and equipment

Property and equipment are recorded at cost. The Company provides for depreciation and amortization on a straight-line basis over the following estimated useful lives:

Land improvements	20
Buildings	

	39-40
Furniture, fixtures and equipment	3-10

Improvements of leased properties are amortized over the shorter of the life of the applicable lease term or the estimated useful life of the asset.

Impairment of long-lived assets

When indicators of impairment are present, the Company evaluates the carrying value of long-lived assets, other than goodwill, in relation to the operating performance and future cash flows or the appraised values of the underlying assets. In accordance with accounting standards for long-lived assets, the Company reviews for impairment stores open more than two years for which current cash flows from operations are negative. Impairment results when the carrying value of the assets exceeds the undiscounted future cash flows over the life of the lease. The Company s estimate of undiscounted future cash flows over the lease term is based upon historical operations of the stores and estimates of future store profitability which encompasses many factors that are subject to variability and difficult to predict. If a long-lived asset is found to be impaired, the amount recognized for impairment is equal to the difference between the carrying value and the asset s estimated fair value. The fair value is estimated based primarily upon estimated future cash flows (discounted at the Company s credit adjusted risk-free rate) or other reasonable estimates of fair market value. Assets to be disposed of are adjusted to the fair value less the cost to sell if less than the book value.

The Company recorded impairment charges included in SG&A expense of approximately $1.7 million in 2010, $5.0 million in 2009 and $4.0 million in 2008, to reduce the carrying value of certain of its stores assets. Such action was deemed necessary based on the Company s evaluation that such amounts would not be recoverable primarily due to insufficient sales or excessive costs resulting in negative current and projected future cash flows at these locations.

Capitalized interest

To assure that interest costs properly reflect only that portion relating to current operations, interest on borrowed funds during the construction of property and equipment is capitalized where applicable. No interest costs were capitalized in 2010, 2009 or 2008.

Goodwill and other intangible assets

The Company amortizes intangible assets over their estimated useful lives unless such lives are deemed indefinite. Amortizable intangible assets are tested for impairment when indicators of impairment are present, based on undiscounted cash flows, and if impaired, written down to fair value based on either discounted cash flows or appraised values.

Goodwill and intangible assets with indefinite lives are tested for impairment annually or more frequently if indicators of impairment are present and written down to fair value as required. No impairment of intangible assets has been identified during any of the periods presented.

The goodwill impairment test is a two-step process that requires management to make judgments in determining what assumptions to use in the calculation. The first step of the process consists of estimating the fair value of the Company s reporting unit based on valuation techniques (including a discounted cash flow model using revenue and profit forecasts) and comparing that estimated fair value with the recorded carrying value, which includes goodwill. If the estimated fair value is less than the carrying value, a second step is performed to compute the amount of the impairment by determining an implied fair value of goodwill. The determination of the implied fair value of goodwill would require the Company to allocate the estimated fair value of its reporting unit to its assets and liabilities. Any unallocated fair value would represent the implied fair value of goodwill, which would be compared to its corresponding carrying value.

Other assets

Non-current Other assets consist primarily of qualifying prepaid expenses, debt issuance costs which are amortized over the life of the related obligations, and utility and security deposits.

Accrued expenses and other liabilities

Accrued expenses and other consist of the following:

(In thousands)	January 28, 2011	January 29, 2010
Compensation and benefits	$ 81,786	$ 100,843
Insurance	76,372	

	65,408	
Taxes (other than taxes on income)	74,900	72,902
Other	114,683	103,137
	$ 347,741	$ 342,290

Other accrued expenses primarily include the current portion of liabilities for legal settlements, freight expense, contingent rent expense, interest, utilities, common area and other maintenance charges, and income tax related reserves.

Insurance liabilities

The Company retains a significant portion of risk for its workers compensation, employee health, general liability, property and automobile claim exposures. Accordingly, provisions are made for the Company s estimates of such risks. The undiscounted future claim costs for the workers compensation, general liability, and health claim risks are derived using actuarial methods. To the extent that subsequent claim costs vary from those estimates, future results of operations will be affected. Ashley River Insurance Company (or ARIC, as defined above), a South Carolina-based wholly owned captive insurance subsidiary of the Company, charges the operating subsidiary companies premiums to insure the retained workers compensation and non-property general liability exposures. Pursuant to South Carolina insurance regulations, ARIC is required to maintain certain levels of cash and cash equivalents related to its self insured exposures. ARIC currently insures no unrelated third-party risk.

As a result of the Merger discussed in Note 3, the Company recorded its assumed self-insurance reserves as of the Merger date at their present value in accordance with applicable accounting standards for business combinations, using a discount rate of 5.4%. The balance of the resulting discount was $4.8 million and $7.4 million at January 28, 2011 and January 29, 2010, respectively. Other than for reserves assumed in a business combination, the Company s policy is to record self-insurance reserves on an undiscounted basis.

Operating leases and related liabilities

Rent expense is recognized over the term of the lease. The Company records minimum rental expense on a straight-line basis over the base, non-cancelable lease term commencing on the date that the Company takes physical possession of the property from the landlord, which normally includes a period prior to the store opening to make necessary leasehold improvements and install store fixtures. When a lease contains a predetermined fixed escalation of the minimum rent, the Company recognizes the related rent expense on a straight-line basis and records the difference between the recognized rental expense and the amounts payable under the lease as deferred rent. Tenant allowances, to the extent received, are recorded as deferred incentive rent and are amortized as a reduction to rent expense over the term of the lease. Any difference between the calculated expense and the amounts actually paid are reflected as a liability, with the current portion in Accrued expenses and other and the long-term portion in Other liabilities in the consolidated balance sheets, and totaled approximately $23.2 million and $14.5 million at January 28, 2011 and January 29, 2010, respectively.

The Company recognizes contingent rental expense when the achievement of specified sales targets are considered probable, in accordance with applicable accounting standards for contingent rent. The amount expensed but not paid as of January 28, 2011 and January 29, 2010 was approximately $9.2 million and $10.8 million, respectively, and is included in Accrued expenses and other in the consolidated balance sheets (See Note 9).

In the normal course of business, based on an overall analysis of store performance and expected trends, management periodically evaluates the need to close underperforming stores. Generally, for store closures where a lease obligation still exists, the Company records the estimated future liability associated with the rental obligation on the date the store is closed in accordance with applicable accounting standards for costs associated with exit or disposal activities. Key assumptions in calculating the liability include the timeframe expected to terminate lease agreements, estimates related to the sublease potential of closed locations, and estimation of other related exit costs. Liabilities are reviewed periodically and adjusted when necessary. The current portion of the closed store rent liability is reflected in Accrued expenses and other and the long-term portion in Other liabilities in the consolidated balance sheets, and totaled approximately $7.0 million and $7.6 million at January 28, 2011 and January 29, 2010, respectively.

Other liabilities

Non-current Other liabilities consist of the following:

(In thousands)	January 28, 2011	January 29, 2010

Compensation and benefits	$ 14,531	$ 12,441
Insurance	131,912	140,633
Income tax related reserves	27,255	68,021
Derivatives	34,923	57,058

Other