DOLLAR GENERAL CORP
Form 10-Q
June 07, 2007

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

FORM 10-Q

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

For the quarterly period ended May 4, 2007

Commission file number: 001-11421

DOLLAR GENERAL CORPORATION
(Exact Name of Registrant as Specified in Its Charter)

TENNESSEE	**61-0502302**
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification No.)*

100 MISSION RIDGE
GOODLETTSVILLE, TENNESSEE 37072
(Address of Principal Executive Offices, Zip Code)

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

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer [X]   Accelerated filer [ ]   Non-accelerated filer [ ]

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

The number of shares of common stock outstanding on June 4, 2007, was 314,875,658.

PART I—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

DOLLAR GENERAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

	May 4, 2007 (Unaudited)	February 2, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 204,417	$ 189,288
Short-term investments	27,371	29,950
Merchandise inventories	1,444,313	1,432,336
Income taxes receivable	14,624	9,833
Deferred income taxes	37,860	24,321
Prepaid expenses and other current assets	57,572	57,020
Total current assets	1,786,157	1,742,748
Net property and equipment	1,212,198	1,236,874
Deferred income taxes	12,418	-
Other assets, net	63,536	60,892
Total assets	$ 3,074,309	$ 3,040,514
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term obligations	$ 7,186	$ 8,080
Accounts payable	484,949	555,274
Accrued expenses and other	258,090	253,558
Income taxes payable	48	15,959
Total current liabilities	750,273	832,871
Long-term obligations	260,373	261,958
Deferred income taxes	-	41,597
Other liabilities	266,886	158,341
Shareholders' equity:		
Preferred stock	-	-
Common stock	157,298	156,218
Additional paid-in capital	525,830	486,145
Retained earnings	1,114,170	1,103,951
Accumulated other comprehensive loss	(941)	(987)
Other shareholders' equity	420	420
Total shareholders' equity	1,796,777	1,745,747
Total liabilities and shareholders' equity	$ 3,074,309	$ 3,040,514

See notes to condensed consolidated financial statements.

DOLLAR GENERAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
(In thousands except per share amounts)

	For the 13 weeks ended	
	May 4, 2007	May 5, 2006
Net sales	$2,275,267	$2,151,387
Cost of goods sold	1,642,207	1,567,113
Gross profit	633,060	584,274
Selling, general and administrative	577,692	502,989
Operating profit	55,368	81,285
Interest income	(2,573)	(2,450)
Interest expense	6,167	7,247
Income before income taxes	51,774	76,488
Income taxes	16,899	28,818
Net income	$ 34,875	$ 47,670
Earnings per share:		
Basic	$ 0.11	$ 0.15
Diluted	$ 0.11	$ 0.15
Weighted average common shares outstanding:		
Basic	313,567	313,997
Diluted	315,928	315,233
Dividends per share	$ 0.05	$ 0.05

See notes to condensed consolidated financial statements.

DOLLAR GENERAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	For the 13 weeks ended May 4, 2007	May 5, 2006
Cash flows from operating activities:		
Net income	$ 34,875	$ 47,670
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	50,451	48,778
Deferred income taxes	(4,948)	5,602
Noncash share-based compensation	3,469	1,740
Tax benefit from stock option exercises	(3,529)	(1,461)
Change in operating assets and liabilities:		
Merchandise inventories	(11,977)	(161,704)
Prepaid expenses and other current assets	(552)	(12,429)
Accounts payable	(62,870)	69,467
Accrued expenses and other	25,647	6,118
Income taxes	(1,736)	(20,236)
Other	456	339
Net cash provided by (used in) operating activities	29,286	(16,116)
Cash flows from investing activities:		
Purchases of property and equipment	(34,101)	(77,102)
Purchases of short-term investments	-	(10,476)
Sales of short-term investments	6,000	6,000
Purchases of long-term investments	(5,670)	(10,809)
Proceeds from sale of property and equipment	169	303
Net cash used in investing activities	(33,602)	(92,084)
Cash flows from financing activities:		
Borrowings under revolving credit facility	-	116,500
Repayments of borrowings under revolving credit facility	-	(51,500)
Repayments of long-term obligations	(2,653)	(2,364)
Payment of cash dividends	(15,712)	(15,686)
Proceeds from exercise of stock options	34,281	10,934
Repurchases of common stock	-	(79,947)
Tax benefit from stock option exercises	3,529	1,461
Other financing activities	-	69
Net cash provided by (used in) financing activities	19,445	(20,533)
Net increase (decrease) in cash and cash equivalents	15,129	(128,733)
Cash and cash equivalents, beginning of period	189,288	200,609
Cash and cash equivalents, end of period	$ 204,417	$ 71,876

Supplemental schedule of noncash investing and financing activities:

Purchases of property and equipment awaiting processing for payment, included in Accounts payable	$	10,639	$	16,344
Purchases of property and equipment under capital lease obligations	$	163	$	877

See notes to condensed consolidated financial statements.

DOLLAR GENERAL CORPORATION AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
(Unaudited)

1. Basis of presentation

The accompanying unaudited condensed consolidated financial statements of Dollar General Corporation and its subsidiaries (the “Company”) have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and are presented in accordance with the requirements of Form 10-Q and Rule 10-01 of Regulation S-X. Such financial statements consequently do not include all of the disclosures normally required by GAAP or those normally made in the Company’s Annual Report on Form 10-K. Accordingly, the reader of this Quarterly Report on Form 10-Q should refer to the Company’s Annual Report on Form 10-K for the year ended February 2, 2007 for additional information.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the Company’s customary accounting practices. In management’s opinion, all adjustments (which are of a normal recurring nature) necessary for a fair presentation of the consolidated financial position as of May 4, 2007 and results of operations for the 13-week quarterly accounting periods ended May 4, 2007 and May 5, 2006 have been made.

Ongoing estimates of inventory shrinkage and initial markups and markdowns are included in the interim cost of goods sold calculation. Because the Company’s business is moderately seasonal, the results for interim periods are not necessarily indicative of the results to be expected for the entire year.

Certain financial statement amounts relating to prior periods have been reclassified to conform to the current period presentation, including the separate disclosure of noncash share-based compensation on the condensed consolidated statement of cash flows.

As discussed in Note 7, effective February 3, 2007, the Company changed its accounting for income taxes in connection with the adoption of Financial Accounting Standards Board (“FASB”) Interpretation 48, Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement 109 (“FIN 48”).

2. Agreement and plan of merger

On March 11, 2007, the Company entered into an Agreement and Plan of Merger (the “Merger Agreement”) with Buck Holdings L.P., a Delaware limited partnership (“Parent”) and Buck Acquisition Corp., a Tennessee corporation and wholly owned subsidiary of Parent (“Merger Sub”).

Pursuant to the Merger Agreement, Merger Sub will be merged with and into the Company (the “Merger”), with the Company surviving the Merger as a wholly owned subsidiary of Parent. Merger Sub and Parent are affiliates of Kohlberg Kravis Roberts & Co., L.P. (“KKR”). Pursuant to the Merger Agreement, at the effective time of the Merger, each outstanding share of common stock of the Company, other than any shares held by any wholly-owned subsidiary of the Company and any shares owned by Parent or Merger Sub or held by the Company, will be cancelled and converted into the right to receive $22.00 in cash, without interest (the "Merger Consideration"). In addition, immediately prior to the effective time of the Merger, all shares of Company restricted stock and restricted stock units will, unless otherwise agreed by the holder and Parent, vest and be converted into the right to receive the Merger Consideration. All options to acquire shares of Company common stock will vest immediately prior to the effective time of the Merger and holders of such options will, unless otherwise agreed by the holder and Parent, be entitled to receive an amount in cash equal to the excess, if any, of the Merger Consideration over the exercise price per share of Company common stock subject to the option.

The Board of Directors of the Company unanimously approved the Merger Agreement and amended the Company's Shareholder Rights Plan to exempt the Merger from that Plan's operation.

Consummation of the Merger is not subject to a financing condition but is subject to customary closing conditions, including approval of the Merger Agreement by the Company's shareholders, regulatory approval and other customary closing conditions. The Merger Agreement places specified restrictions on certain of the Company's business activities, including but not limited to: acquisitions or dispositions of assets, capital expenditures, modifications of debt, leasing activities, compensatory changes, dividend increases, investments and share repurchases. The accompanying condensed consolidated financial statements do not include any financial reporting impacts related to the potential consummation of the Merger, including but not limited to potential changes in the basis of accounting and acceleration of vesting of restricted stock, stock units or options. A special meeting of shareholders has been scheduled for June 21, 2007 for the purpose of voting on the proposed merger.

Subsequent to the announcement of the Merger Agreement, the Company announced that Merger Sub has commenced a cash tender offer to purchase any and all of the Company's $200 million (principal amount) of 8 5/8% unsecured notes due June 15, 2010. The tender offer is contingent upon the closing of the Merger.

Also subsequent to the announcement of the Merger Agreement, the Company and its directors were named in seven putative class actions alleging claims for breach of fiduciary duty arising out of the proposed sale of the Company to KKR, all as described more fully under "Legal Proceedings" in Note 6 below.

3. Strategic initiatives

In its Quarterly Report on Form 10-Q for the quarterly period ended August 4, 2006, the Company announced it was considering modifying its historical inventory management model and accelerating its enhanced real estate strategy. The outcome of these deliberations is set forth below.

Inventory management

In November 2006, the Company's Board of Directors approved management's recommendation to discontinue the Company's historical inventory packaway model by the end of fiscal 2007. With few exceptions, the Company plans to eliminate, through end-of-season and other markdowns, existing seasonal, home products and basic clothing packaway merchandise by the close of fiscal 2007 to allow for increased levels of newer, current-season merchandise. In connection with this strategic change, the Company incurred higher markdowns and writedowns on inventory in the second half of 2006 and the first quarter of 2007 than in the comparable prior-year periods. Markdowns which were expected to reduce inventory below cost were considered in the Company's lower of cost or market estimate and recorded at such time as the utility of the underlying inventory was deemed to be impaired. During 2006, the Company recorded lower of cost or market inventory impairment estimates, which resulted in a reserve balance of approximately $45.6 million as of February 2, 2007. This reserve was reduced by $12.3 million during the first quarter of 2007, to account for sales of products with markdowns below cost, higher than anticipated shrink during the period, and adjustments to the estimates of the remaining below cost markdowns to be taken, resulting in a balance of approximately $33.3 million as of May 4, 2007. The inventory for which these impairment estimates have been recorded is expected to be sold during 2007. Markdowns which are not below cost impact the Company's gross profit in the period in which such markdowns are taken. The amount of the below-cost inventory adjustment is based on management's assumptions regarding the timing and adequacy of markdowns and the final adjustment may vary materially from the amount recorded depending on various factors, including timing of the execution of the plan, retail market conditions and the accuracy of assumptions used by management in developing these estimates.

Exit and disposal activities

In November 2006, the Company's Board of Directors approved management's recommendation to close, in addition to those stores that might be closed in the ordinary course of business, approximately 400 stores by the end of fiscal 2007 (281 of which have been closed as of May 4, 2007), and the Company has incurred or expects to incur the following pretax costs associated with the closing of these stores (in millions):

	Estimated Total (a)	**Incurred in 2006**	**Incurred in 2007**	**Remaining**
Lease contract termination costs (b)	$ 36.6	$ 5.7	$ $ 15.3	$ 15.6
One-time employee termination benefits	0.9	0.3	0.3	0.3
Other associated store closing costs	8.1	0.2	2.2	5.7
Inventory liquidation fees	4.6	1.6	1.5	1.5
Asset impairment & accelerated depreciation	9.0	8.3	0.3	0.4
Inventory markdowns below cost	7.8	6.7	1.1	-
Total	$ 67.0	$ 22.8	$ $ 20.7	$ 23.5

(a) Reflects estimates as of May 4, 2007, which, in total, are $6.0 million less than estimates as of February 2, 2007.
(b) Including estimated reversals of deferred rent accruals totaling $0.8 million, of which $0.1 million is reflected in 2006, $0.3 million is reflected in 2007, and $0.4 million is remaining.

Other associated store closing costs as listed in the table above primarily include the removal of any usable assets as well as real estate consulting and other services.

Liability balances related to activities discussed above for stores closed to date are as follows (in millions):

	Balance, February 2, 2007	2007 Expenses	2007 Payments and Other	Balance, May 4, 2007
Lease contract termination costs	$ 5.0	$15.6	$ 2.4	$ 18.2
One-time employee termination benefits	0.3	0.3	0.6	-
Other associated store closing costs	0.2	2.2	1.4	1.0
Inventory liquidation fees	0.3	1.5	1.8	-
Total	$ 5.8	$19.6	$ 6.2	$ 19.2

All expenses associated with exit and disposal activities are included in selling, general and administrative ("SG&A") expenses with the exception of the below-cost inventory adjustments, which are included in cost of goods sold in the condensed consolidated statement of income for the first quarter of 2007. As noted above, the Company expects to incur additional charges in future periods when the related expenses are incurred. The estimated amount and timing of these future costs and charges are dependent on various factors, including timing of the execution of the plan, the outcome of negotiations with landlords and/or potential sublease tenants, and final inventory levels.

4. Share-based payments

The Company has a shareholder-approved stock incentive plan under which stock options, restricted stock, restricted stock units and other equity-based awards may be granted to officers, directors and key employees. Effective February 4, 2006, the Company adopted Statement of Financial Accounting Standards 123 (Revised 2004) "Share-Based Payment," ("SFAS 123(R)"). Under SFAS 123(R), the fair value of each option grant is separately estimated. The fair value of each option is amortized into compensation expense on a straight-line basis between the grant date for the award and each vesting date. The Company has estimated the fair value of all stock option awards as of the date of the grant by applying the Black-Scholes-Merton option pricing valuation model. The application of this valuation model involves assumptions that are judgmental and highly sensitive in the determination of compensation expense. The weighted average for key assumptions used in determining the fair value of options granted in the 13-week periods ended May 4, 2007 and May 5, 2006 are as follows:

	13 Weeks Ended	
	May 4, 2007	May 5, 2006
Expected dividend yield	0.91%	0.82%
Expected stock price volatility	18.5%	28.7%
Weighted average risk-free interest rate	4.5%	4.7%
Expected term of options (years)	5.7	5.7

For the 13-week periods ended May 4, 2007 and May 5, 2006, the fair value method of SFAS 123(R) resulted in share-based compensation expense (a component of SG&A) for outstanding stock options and a corresponding reduction of pre-tax income in the amount of $1.4 million and $1.0 million, respectively.

The Company generally issues new shares when options are exercised. A summary of stock option activity during the 13 weeks ended May 4, 2007 is as follows:

	Options Issued	Weighted Average Exercise Price
Balance, February 2, 2007	19,398,881	$18.38
Granted	1,997,198	21.15
Exercised	(2,091,451)	16.39
Canceled	(187,100)	19.90
Balance, May 4, 2007	19,117,528	$18.88

All stock options granted in the 13-week periods ended May 4, 2007 and May 5, 2006 under the terms of the Company's stock incentive plan were non-qualified stock options issued at a price equal to the fair market value of the Company's common stock on the date of grant, were originally scheduled to vest ratably over a four-year period, and expire 10 years following the date of grant.

A summary of activity related to nonvested restricted stock and restricted stock unit awards during the 13-week period ended May 4, 2007 is as follows:

	Nonvested Shares	Weighted Average Grant Date Fair Value
Balance, February 2, 2007	748,631	$16.63
Granted	708,108	21.15
Vested	(94,283)	18.66
Canceled	(10,037)	20.29
Balance, May 4, 2007	1,352,419	$18.83

The Company accounts for nonvested restricted stock and restricted stock unit awards in accordance with the provisions of SFAS 123(R). The Company calculates compensation expense as the difference between the market price of the underlying stock on the date of grant and the purchase price, if any, and recognizes such amount on a straight-line basis over the period in which the recipient earns the nonvested restricted stock and restricted stock unit award.

The purchase price was set at zero for all nonvested restricted stock and restricted stock unit awards in the 13-week periods ended May 4, 2007 and May 5, 2006, and such awards are scheduled to vest ratably over a three-year period from the respective grant dates. The Company recognized compensation expense relating to its nonvested restricted stock and restricted stock unit awards of approximately $2.1 million and $0.8 million in the 13-week periods ended May 4, 2007 and May 5, 2006, respectively.

The Company recognized total compensation expense relating to share-based awards of approximately $3.5 million and $1.8 million in the 2007 and 2006 periods, respectively.

Under SFAS 123(R), the benefits of tax deductions in excess of recognized compensation cost are reported as a financing cash flow. For the 13-week periods ended May 4, 2007 and May 5, 2006, this excess tax benefit was approximately $3.5 million and $1.5 million, respectively.

5. Earnings per share

Earnings per share is computed as follows (in thousands, except per share data):

	13 Weeks Ended May 4, 2007		
	Net Income	Shares	Per Share Amount
Basic earnings per share	$ 34,875	313,567	$ 0.11
Effect of dilutive stock awards		2,361	
Diluted earnings per share	$ 34,875	315,928	$ 0.11

	13 Weeks Ended May 5, 2006		
	Net Income	Shares	Per Share Amount
Basic earnings per share	$ 47,670	313,997	$ 0.15
Effect of dilutive stock awards		1,236	
Diluted earnings per share	$ 47,670	315,233	$ 0.15

Basic earnings per share was computed by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share was determined based on the dilutive effect of stock options and other common stock equivalents using the treasury stock method.

6. Commitments and contingencies

Legal proceedings

On October 10, 2005, the Company was served with a lawsuit entitled *Moldoon, et al. v. Dolgencorp, Inc., et al.* (Western District of Louisiana, Lake Charles Division, CV05-0852, filed May 19, 2005), filed as a putative collective action in which five current or former store managers claim to have been improperly classified as exempt executive employees under the Fair Labor Standards Act ("FLSA"). Plaintiffs seek injunctive relief, back wages, liquidated damages and attorneys' fees. To date, Plaintiffs have not asked the Court to certify any class.

On August 7, 2006, a lawsuit entitled *Cynthia Richter, et al. v. Dolgencorp, Inc., et al.* was filed in the United States District Court for the Northern District of Alabama (Case No. 7:06-cv-01537-LSC) in which the plaintiff alleges that she and other current and former Dollar General store managers were improperly classified as exempt executive employees under the FLSA and seeks to recover overtime pay, liquidated damages, and attorneys' fees and costs. On August 15, 2006, the *Richter* plaintiff filed a motion in which she asked the court to certify a nationwide class of current and former store managers. The Company opposed the plaintiff's motion. On March 23, 2007, the Court conditionally certified a nationwide class of individuals who worked for Dollar General as Store Managers since August 7, 2003. Although the number of persons who will be included in the class has not been determined, the parties have agreed to, and the Court is expected to approve, the Notice that will be sent to the class.

On May 30, 2007, the Court stayed all proceedings in the case, including the sending of the Notice, for an initial period of 60 days, during which time the Court will evaluate, among other things, a recently filed appeal in the Eleventh Circuit involving claims similar to those raised in this action. During the 60-day stay, the statute of limitations will be tolled for potential class members. At its conclusion, the Court will determine whether to extend the stay or to permit this action to proceed. Following the close of the discovery period the Company will have an opportunity to seek decertification of the class, and the Company expects to file such a motion.

The Company believes that its store managers are and have been properly classified as exempt employees under the FLSA and that the actions described above are not appropriate for collective action treatment. The Company intends to vigorously defend these actions. However, at this time, it is not possible to predict whether the courts will permit these actions to proceed collectively, and no assurances can be given that the Company will be successful in its defense on the merits or otherwise. If the Company is not successful in its efforts to defend these actions, the resolution or resolutions could have a material adverse effect on the Company's financial statements as a whole.

On May 18, 2006, the Company was served with a lawsuit entitled *Tammy Brickey, Becky Norman, Rose Rochow, Sandra Cogswell and Melinda Sappington v. Dolgencorp, Inc. and Dollar General Corporation* (Western District of New York, Case 6:06-cv-06084-DGL, originally filed on February 9, 2006 and amended on May 12, 2006 ("*Brickey"*)). The *Brickey* plaintiffs seek to proceed collectively under the FLSA and as a class under New York, Ohio, Maryland and North Carolina wage and hour statutes on behalf of, among others, individuals employed by the Company as assistant store managers who claim to be owed wages (including overtime wages) under those statutes. At this time, it is not possible to predict whether the court will permit this action to proceed collectively or as a class. However, the Company believes that this action is not appropriate for either collective or class treatment, and believes that its wage and hour policies and practices comply with both federal and state law. The Company plans to vigorously defend this action; however, no assurances can be given that the Company will be successful in its defense on the merits or otherwise, and, if it is not, the resolution of this action could have a material adverse effect on the Company's financial statements as a whole.

On March 7, 2006, a complaint was filed in the United States District Court for the Northern District of Alabama (*Janet Calvert v. Dolgencorp, Inc.*, Case No. 2:06-cv-00465-VEH *("Calvert"*)), in which the plaintiff, a former store manager, alleged that she was paid less than male store managers because of her sex, in violation of the Equal Pay Act and Title VII of the Civil Rights Act of 1964, as amended ("Title VII"). On March 9, 2006, the *Calvert* complaint was amended to include seven additional plaintiffs, who also allege to have been paid less than males because of their sex, and to add allegations of sex discrimination in promotional opportunities and undefined terms and conditions of employment. In addition to allegations of intentional sex discrimination, the amended *Calvert* complaint also alleges that the Company's employment policies and practices have a disparate impact on females. The amended *Calvert* complaint seeks to proceed collectively under the Equal Pay Act and as a class under Title VII, and requests back wages, injunctive and declaratory relief, liquidated damages and attorney's fees and costs.

At this time, it is not possible to predict whether the court will permit *Calvert* to proceed collectively or as a class. However, the Company believes that the case is not appropriate for class or collective treatment and believes that its policies and practices comply with the Equal Pay Act and Title VII. The Company intends to vigorously defend the action; however, no assurances can be given that the Company will be successful in its defense on the merits or otherwise. If the Company is not successful in defending the *Calvert* action, its resolution could have a material adverse effect on the Company's financial statements as a whole.

On September 8, 2005, the Company received a request for information from the Environmental Protection Agency (EPA) with respect to Krazy String, a product that was offered for sale in the Company's stores. The EPA asserted that Krazy String contained an aerosol that included an ozone depleting substance in violation of the Clean Air Act. On July 12, 2006, the Company agreed to an Administrative Compliance Order requiring the destruction of the Krazy String remaining in inventory. After advising the Company that it was considering imposing a penalty in connection with Krazy String, on February 5, 2007, the EPA proposed a penalty of approximately $800,000. The Company believed that amount to be excessive under applicable EPA policies. After additional discussions with the EPA on May 7, 2007, the Company and the EPA agreed in principle on May 31, 2007 to resolve this matter through payment by the Company of a $155,826 penalty. The Company expects to finalize this settlement within the next 90 days.

Subsequent to the announcement of the Agreement and Plan of Merger among the Company, Buck Holdings L.P. and Buck Acquisition Corp (each of Buck Holdings L.P. and Buck Acquisition Corp is an affiliate of KKR, as more fully described in Note 2), the Company and its directors were named in seven putative class actions alleging claims for breach of fiduciary duty arising out of the proposed sale of the Company to KKR. Each of the complaints alleged, among other things, that Dollar General's directors engaged in "self-dealing" by agreeing to recommend the transaction to the shareholders of Dollar General and that the consideration available to Dollar General shareholders in the proposed transaction is unfairly low. On motion of the plaintiffs, each of these cases was transferred to the Sixth Circuit Court for Davidson County, Twentieth Judicial District, at Nashville (the "Court"). By order April 26, 2007, the seven lawsuits were consolidated in the Court under the caption, "In re: Dollar General," Case No. 07MD-1. On May 23, 2007, the Court entered an order requiring the plaintiffs in the consolidated actions to file a consolidated complaint within 30 days. According to the terms of the order, the consolidated complaint will supersede all previously-filed complaints. The Company believes that the foregoing lawsuit is without merit and intends to defend the action vigorously.

In addition to the matters described above, the Company is involved in other legal actions and claims arising in the ordinary course of business. The Company believes, based upon information currently available, that such other litigation and claims, both individually and in the aggregate, will be resolved without a material effect on the Company's financial statements as a whole. However, litigation involves an element of uncertainty. Future developments could cause these actions or claims to have a material adverse effect on the Company's financial statements as a whole.

7. Income taxes

The Company adopted the provisions of FIN 48 effective February 3, 2007. The adoption resulted in an $8.9 million decrease in retained earnings and a reclassification of certain amounts between deferred income taxes and other noncurrent liabilities to conform to the balance sheet presentation requirements of FIN 48. As of the date of adoption, the total reserve for uncertain tax benefits was $77.9 million. This reserve excludes the federal income tax benefit for the uncertain tax positions related to state income taxes, which is now included in deferred tax assets. As a result of the adoption of FIN 48, the reserve for interest expense related to income taxes was increased to $15.3 million and a reserve for potential penalties of $1.9 million related to uncertain income tax positions was recorded. As of the date of adoption, approximately $27.1 million of the reserve for uncertain tax positions would impact our effective income tax rate if we were to recognize the tax benefit for these positions.

Subsequent to the adoption of FIN 48, the Company has elected to record income tax related interest and penalties as a component of the provision for income tax expense.

In the quarter ended May 4, 2007, the Internal Revenue Service completed an examination of the Company's federal income tax returns through fiscal year 2003 resulting in a net income tax refund. There are no unresolved issues related to this examination. In connection with this examination, the Company and the Internal Revenue Service agreed to extend the statute of limitations related to the 2003 fiscal year through October 2007. Accordingly, the 2003 fiscal year could be subject to further examination by the Internal Revenue Service until that date, however, the Company believes that such further examination is unlikely. Also remaining open for examination are the Company's 2004 and later fiscal years. None of the Company's federal income tax returns are currently under examination by the Internal Revenue Service. The Company has various state income tax examinations that are currently in progress. The estimated liability related to these state income tax examinations is included in the Company's reserve for uncertain tax positions. Generally, the Company's tax years ended in 2004 and forward remain open for examination by the various state taxing authorities.

As of May 4, 2007, the total reserves for uncertain tax benefits, interest expense related to income taxes and potential income tax penalties were $77.8 million, $14.2 million and $1.5 million, respectively, of which a total of $84.3 million is reflected in other noncurrent liabilities in the condensed consolidated balance sheet. The Company believes that it is reasonably possible that the reserve for uncertain tax positions may be reduced by approximately $6.2 million in the coming twelve months as a result of the settlement of currently ongoing state income tax examinations.

The effective income tax rate for the 13-week period ended May 4, 2007 was 32.6%, or 5.1% lower than the rate of 37.7% for the 13-week period ended May 5, 2006. The decrease in the effective income tax rate was primarily due to the following: an approximate 1.2% decrease as a result of the renewal, in late 2006, of the federal laws which allow the Company to claim federal job credits for certain newly hired employees; and an approximate decrease of 6.3% in the 2007 period related to the settlement of income tax contingencies that did not occur in the 2006 period. These decreases were partially offset by the following items which increased the effective income tax rate: an approximate 0.7% increase due principally to state income tax expense resulting from state law changes in the States of New York and Texas; an approximate 0.1% increase due to lower state job related tax credits (principally job credits earned in 2006 for the Company's South Carolina distribution center that did not reoccur in 2007); an increase of approximately 1.7% due to the post-FIN 48 inclusion of income tax related interest expense in the amount reported as income tax expense in 2007; and an increase of approximately 0.7% related to non-deductible expenses incurred in connection with the proposed Merger.

8. Segment reporting

The Company manages its business on the basis of one reportable segment. As of May 4, 2007, all of the Company's operations were located within the United States, with the exception of a Hong Kong subsidiary, the assets and revenues of which are not material. The following data is presented in accordance with SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information."

	13 Weeks Ended	
(In thousands)	May 4, 2007	May 5, 2006
Classes of similar products:		
Highly consumable	$ 1,523,793	$ 1,455,984
Seasonal	336,449	309,583
Home products	215,046	211,665
Basic clothing	199,979	174,155
Net sales	$ 2,275,267	$ 2,151,387

9. Guarantor subsidiaries

All of the Company's subsidiaries, except for its not-for-profit subsidiary, the assets and revenues of which are not material (the "Guarantors"), have fully and unconditionally guaranteed on a joint and several basis the Company's obligations under certain outstanding debt obligations. Each of the Guarantors is a direct or indirect wholly-owned subsidiary of the Company.

The following consolidating schedules present condensed financial information on a combined basis.

(In thousands)	As of May 4, 2007			
	DOLLAR GENERAL CORPORATION	**GUARANTOR SUBSIDIARIES**	**ELIMINATIONS**	**CONSOLIDATED TOTAL**
BALANCE SHEET: ASSETS				
Current assets:				
Cash and cash equivalents	$ 113,533	$ 90,884	$ -	$ 204,417
Short-term investments	-	27,371	-	27,371
Merchandise inventories	-	1,444,313	-	1,444,313
Income taxes receivable	21,037	-	(6,413)	14,624
Deferred income taxes	8,626	29,234	-	37,860
Prepaid expenses and other current assets	169,257	1,130,040	(1,241,725)	57,572
Total current assets	312,453	2,721,842	(1,248,138)	1,786,157
Property and equipment, at cost	215,158	2,229,975	-	2,445,133
Less accumulated depreciation and amortization	120,377	1,112,558	-	1,232,935
Net property and equipment	94,781	1,117,417	-	1,212,198
Deferred income taxes	9,899	2,519	-	12,418
Other assets, net	2,760,254	45,982	(2,742,700)	63,536
Total assets	$ 3,177,387	$ 3,887,760	$ (3,990,838)	$ 3,074,309
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities:				
Current portion of long-term obligations	$ -	$ 7,186	$ -	$ 7,186
Accounts payable	1,111,885	612,082	(1,239,018)	484,949
Accrued expenses and other	29,785	231,012	(2,707)	258,090
Income taxes payable	-	6,461	(6,413)	48
Total current liabilities	1,141,670	856,741	(1,248,138)	750,273
Long-term obligations	199,853	1,636,664	(1,576,144)	260,373
Other liabilities	39,087	227,799	-	266,886
Shareholders' equity:				
Preferred stock	-	-	-	-
Common stock	157,298	23,853	(23,853)	157,298
Additional paid-in capital	525,830	673,611	(673,611)	525,830
Retained earnings	1,114,170	469,092	(469,092)	1,114,170

Accumulated other comprehensive loss	(941)	-	-	(941)
Other shareholders’ equity	420	-	-	420
Total shareholders’ equity	1,796,777	1,166,556	(1,166,556)	1,796,777
Total liabilities and shareholders’ equity	$ 3,177,387	$ 3,887,760	$ (3,990,838)	$ 3,074,309

(in thousands)	As of February 2, 2007			
	DOLLAR GENERAL CORPORATION	**GUARANTOR SUBSIDIARIES**	**ELIMINATIONS**	**CONSOLIDATED TOTAL**
BALANCE SHEET:				
ASSETS				
Current assets:				
Cash and cash equivalents	$ 114,310	$ 74,978	$ -	$ 189,288
Short-term investments	-	29,950	-	29,950
Merchandise inventories	-	1,432,336	-	1,432,336
Income tax receivable	4,896	4,937	-	9,833
Deferred income taxes	5,099	19,222	-	24,321
Prepaid expenses and other current assets	139,913	1,086,890	(1,169,783)	57,020
Total current assets	264,218	2,648,313	(1,169,783)	1,742,748
Property and equipment, at cost	213,781	2,217,030	-	2,430,811
Less accumulated depreciation and amortization	115,201	1,078,736	-	1,193,937
Net property and equipment	98,580	1,138,294	-	1,236,874
Other assets, net	2,686,697	43,622	(2,669,427)	60,892
Total assets	$3,049,495	$3,830,229	$(3,839,210)	$3,040,514
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities:				
Current portion of long-term obligations	$ -	$ 8,080	$ -	$ 8,080
Accounts payable	1,076,028	647,153	(1,167,907)	555,274
Accrued expenses and other	13,327	242,107	(1,876)	253,558
Income taxes payable	-	15,959	-	15,959
Total current liabilities	1,089,355	913,299	(1,169,783)	832,871
Long-term obligations	199,842	1,584,526	(1,522,410)	261,958
Deferred income taxes	(793)	42,390	-	41,597
Other liabilities	15,344	142,997	-	158,341
Shareholders' equity:				
Preferred stock	-	-	-	-
Common stock	156,218	23,853	(23,853)	156,218
Additional paid-in capital	486,145	673,611	(673,611)	486,145

Retained earnings	1,103,951	449,553	(449,553)	1,103,951
Accumulated other comprehensive loss	(987)	-	-	(987)
Other shareholders' equity	420	-	-	420
Total shareholders' equity	1,745,747	1,147,017	(1,147,017)	1,745,747
Total liabilities and shareholders' equity	$3,049,495	$3,830,229	$(3,839,210)	$3,040,514

(In thousands)	For the 13 weeks ended May 4, 2007			
	DOLLAR GENERAL CORPORATION	**GUARANTOR SUBSIDIARIES**	**ELIMINATIONS**	**CONSOLIDATED TOTAL**
STATEMENTS OF INCOME:				
Net sales	$ 53,535	$ 2,275,267	$ (53,535)	$ 2,275,267
Cost of goods sold	-	1,642,207	-	1,642,207
Gross profit	53,535	633,060	(53,535)	633,060
Selling, general and administrative	45,440	585,787	(53,535)	577,692
Operating profit	8,095	47,273	-	55,368
Interest income	(24,498)	(820)	22,745	(2,573)
Interest expense	4,915	23,997	(22,745)	6,167
Income before income taxes	27,678	24,096	-	51,774
Income taxes	12,342	4,557	-	16,899
Equity in subsidiaries' earnings, net of taxes	19,539	-	(19,539)	-
Net income	$ 34,875	$ 19,539	$ (19,539)	$ 34,875

(In thousands)	For the 13 weeks ended May 5, 2006			
	DOLLAR GENERAL CORPORATION	**GUARANTOR SUBSIDIARIES**	**ELIMINATIONS**	**CONSOLIDATED TOTAL**
STATEMENTS OF INCOME:				
Net sales	$ 38,653	$ 2,151,387	$ (38,653)	$ 2,151,387
Cost of goods sold	-	1,567,113	-	1,567,113
Gross profit	38,653	584,274	(38,653)	584,274
Selling, general and administrative	34,329	507,313	(38,653)	502,989
Operating profit	4,324	76,961	-	81,285
Interest income	(22,382)	(1,748)	21,680	(2,450)
Interest expense	3,798	25,129	(21,680)	7,247
Income before income taxes	22,908	53,580	-	76,488
Income taxes	8,412	20,406	-	28,818
Equity in subsidiaries' earnings, net of taxes	33,174	-	(33,174)	-
Net income	$ 47,670	$ 33,174	$ (33,174)	$ 47,670

(In thousands)	For the 13 weeks ended May 4, 2007			
	DOLLAR GENERAL CORPORATION	**GUARANTOR SUBSIDIARIES**	**ELIMINATIONS**	**CONSOLIDATED TOTAL**
STATEMENTS OF CASH FLOWS:				
Cash flows from operating activities:				
Net income	$ 34,875	$ 19,539	$ (19,539)	$ 34,875
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	5,448	45,003	-	50,451
Deferred income taxes	(4,158)	(790)	-	(4,948)
Noncash share-based compensation	3,469	-	-	3,469
Tax benefit from stock option exercises	(3,529)	-	-	(3,529)
Equity in subsidiaries' earnings, net	(19,539)	-	19,539	-
Change in operating assets and liabilities:				
Merchandise inventories	-	(11,977)	-	(11,977)
Prepaid expenses and other current assets	(764)	212	-	(552)
Accounts payable	(3,913)	(58,957)	-	(62,870)
Accrued expenses and other	4,868	20,779	-	25,647
Income taxes	(12,638)	10,902	-	(1,736)
Other	(486)	942	-	456
Net cash provided by operating activities	3,633	25,653	-	29,286
Cash flows from investing activities:				
Purchases of property and equipment	(3,849)	(30,252)	-	(34,101)
Sales of short-term investments	-	6,000	-	6,000
Purchases of long-term investments	-	(5,670)	-	(5,670)
Proceeds from sale of property and equipment	50	119	-	169
Net cash used in investing activities	(3,799)	(29,803)	-	(33,602)
Cash flows from financing activities:				
Repayments of long-term obligations	(138)	(2,515)	-	(2,653)

Payment of cash dividends	(15,712)	-	-	(15,712)
Proceeds from exercise of stock options	34,281	-	-	34,281
Changes in intercompany note balances, net	(22,571)	22,571	-	-
Tax benefit from stock option exercises	3,529	-	-	3,529
Net cash provided by (used in) financing activities	(611)	20,056	-	19,445
Net increase (decrease) in cash and cash equivalents	(777)	15,906	-	15,129
Cash and cash equivalents, beginning of period	114,310	74,978	-	189,288
Cash and cash equivalents, end of period	$ 113,533	$ 90,884	$ -	$ 204,417

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(In thousands)	For the 13 weeks ended May 5, 2006			
	DOLLAR GENERAL CORPORATION	**GUARANTOR SUBSIDIARIES**	**ELIMINATIONS**	**CONSOLIDATED TOTAL**
STATEMENTS OF CASH FLOWS:				
Cash flows from operating activities:				
Net income	$ 47,670	$ 33,174	$ (33,174)	$ 47,670
Adjustments to reconcile net income to net cash provided by (used in) operating activities:				
Depreciation and amortization	5,287	43,491	-	48,778
Deferred income taxes	(171)	5,773	-	5,602
Noncash share-based compensation	1,740	-	-	1,740
Tax benefit from stock option exercises	(1,461)	-	-	(1,461)
Equity in subsidiaries' earnings, net	(33,174)	-	33,174	-
Change in operating assets and liabilities:				
Merchandise inventories	-	(161,704)	-	(161,704)
Prepaid expenses and other current assets	(4,115)	(8,314)	-	(12,429)
Accounts payable	11,294	58,173	-	69,467
Accrued expenses and other	5,845	273	-	6,118
Income taxes	(1,269)	(18,967)	-	(20,236)
Other	67	272	-	339
Net cash provided by (used in) operating activities	31,713	(47,829)	-	(16,116)
Cash flows from investing activities:				
Purchases of property and equipment	(2,754)	(74,348)	-	(77,102)
Purchases of short-term investments	(6,000)	(4,476)	-	(10,476)
Sales of short-term investments	6,000	-	-	6,000
Purchases of long-term investments	-	(10,809)	-	(10,809)
Proceeds from sale of property and equipment	136	167	-	303
Net cash used in investing activities	(2,618)	(89,466)	-	(92,084)

Cash flows from financing activities:				
Borrowings under revolving credit facility	116,500	-	-	116,500
Repayments of borrowings under revolving credit facility	(51,500)	-	-	(51,500)
Repayments of long-term obligations, net	234	(2,598)	-	(2,364)
Payment of cash dividends	(15,686)	-	-	(15,686)
Proceeds from exercise of stock options	10,934	-	-	10,934
Repurchases of common stock	(79,947)	-	-	(79,947)
Changes in intercompany note balances, net	(121,536)	121,536	-	-
Tax benefit from stock option exercises	1,461	-	-	1,461
Other financing activities	68	1	-	69
Net cash provided by (used in) financing activities	(139,472)	118,939	-	(20,533)
Net decrease in cash and cash equivalents	(110,377)	(18,356)	-	(128,733)
Cash and cash equivalents, beginning of period	110,410	90,199	-	200,609
Cash and cash equivalents, end of period	$ 33	$ 71,843	$ -	$ 71,876

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

General

Accounting Periods. We follow the concept of a 52-53 week fiscal year that ends on the Friday nearest to January 31. The following text contains references to years 2007 and 2006, which represent 52-week fiscal years ending or ended February 1, 2008 and February 2, 2007, respectively. Consequently, references to quarterly accounting periods for 2007 and 2006 contained herein refer to 13-week accounting periods. This discussion and analysis is based on, should be read with, and is qualified in its entirety by, the Condensed Consolidated Financial Statements and the notes thereto. It also should be read in conjunction with the Forward-Looking Statements/Risk Factors disclosure set forth in Part II, Item 1A of this report.

Purpose of Discussion. We intend for this discussion to provide the reader with information that will assist in understanding our company and the critical economic factors that affect our company. In addition, we hope to help the reader understand our financial statements, the changes in certain key items in those financial statements from period to period, and the primary factors that accounted for those changes, as well as how certain accounting principles affect our financial statements.

Proposed Merger. On March 11, 2007, we entered into an Agreement and Plan of Merger (the "Merger Agreement") with Buck Holdings L.P. ("Parent") and Buck Acquisition Corp. ("Merger Sub"), affiliates of Kohlberg Kravis Roberts & Co. ("KKR"), whereby Merger Sub will be merged with and into us (the "Merger"). In the event the Merger is consummated, we will continue as the surviving corporation and as a wholly owned subsidiary of Parent. A special meeting of shareholders has been scheduled for June 21, 2007 for the purpose of voting on the proposed merger.

Executive Overview

The nature of our business is moderately seasonal. Primarily because of sales of holiday-related merchandise, sales in the fourth quarter 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 income, 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.

For the quarter ended May 4, 2007, we had net income of $34.9 million, or $0.11 per diluted share compared to net income of $47.7 million, or $0.15 per diluted share for the quarter ended May 5, 2006. In summary, revenues increased by $123.9 million in the 2007 period, or 5.8%, aided by new stores and a same-store sales increase of 2.4%, while gross profit increased $48.8 million, or 8.4%, resulting in a 0.7% increase in gross profit as a percentage of sales as compared to the prior year period. The increase in gross profit was offset by an increase in selling, general and administrative expenses of $74.7 million, or 2.0% as a percentage of sales, including expenses of approximately $29.6 million relating to the closings of underperforming stores and expenses of $6.1 million incurred in connection with the proposed Merger. See detailed discussions below for additional comments on financial performance in the current year period as compared with the prior year period.

Since the approval of the Merger by our Board of Directors, our management team has been working with representatives from KKR on further evaluating our strategic and operating initiatives. To date, we have not made significant changes to our operating initiatives and plans in place.

We have made significant progress in our efforts, first announced in November 2006, to minimize the amount of merchandise in our stores that we carry over to subsequent periods ("packaway"). We identified the targeted packaway inventories in 2006 and launched programs to sell-through this inventory, eliminating over half of the targeted merchandise by the end of fiscal 2006. As of May 4, 2007, approximately $100 million of such merchandise, at cost, remains to be sold. We are on schedule to achieve our plans with regard to the sale of existing packaway inventories by the end of fiscal 2007. We also plan to sell virtually all current-year non-replenishable merchandise by taking end-of-season markdowns to permit increased levels of newer, current-season merchandise in the future.

Also in November 2006, we announced significant changes to our real estate strategy, including our intention to close, by the end of fiscal 2007, approximately 400 stores that do not meet our revised real estate criteria. As of May 4, 2007, we have closed 281 of the targeted stores, 153 of which were closed in the first quarter of 2007. In addition to store closings, our current plans are to remodel or relocate approximately 200 stores and to decelerate new store openings to approximately 300 new stores in fiscal 2007. In the first quarter, we opened 124 new stores, closed 171 stores, remodeled 25 stores and relocated 15 stores. The majority of these new, remodeled and relocated stores are in our new "racetrack" store layout.

We estimate that we will recognize total pre-tax selling, general and administrative ("SG&A") charges associated with the elimination of the targeted packaway inventories and the closing of these 400 under-performing stores of approximately $102.6 million. Of this total, approximately $29.6 million was reflected in our results of operations in the first quarter of 2007 and $33.4 million was reflected in the third and fourth quarters of 2006, as follows (in millions):

	Estimated Total	Incurred in 2006	Incurred in 2007	Remaining
Lease contract termination costs	$ 36.6	$ 5.7	$$ 15.3	$ 15.6
One-time employee termination benefits	0.9	0.3	0.3	0.3
Other associated store closing costs	8.1	0.2	2.2	5.7
Inventory liquidation fees	4.6	1.6	1.5	1.5
Asset impairment & accelerated depreciation	9.0	8.3	0.3	0.4
Other costs (a)	43.4	17.3	10.0	16.1
Total	$ 102.6	$ 33.4	$$ 29.6	$ 39.6

(a) Includes incremental store labor, advertising and other costs.

The remaining costs outlined in the table above are currently expected to be incurred during 2007, with the majority expected to be incurred in the second quarter. However, the

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amount and timing of these costs and charges as well as the amount of below-cost inventory estimates and adjustments may vary materially depending on various factors, including timing in the execution of the plan, the outcome of negotiations with landlords and/or potential sublease tenants, the accuracy of assumptions used by management in developing these estimates, final inventory levels, the timing and adequacy of markdowns, and retail market conditions.

We expect markdowns from retail to continue at higher than historical levels as we sell through the remaining packaway inventory. We currently expect the gross profit rate to sales to be in the following ranges: 27 to 28 percent in fiscal 2007, 28 to 29 percent in fiscal 2008 and 29 to 30 percent in fiscal 2009. We expect to increase our sales mix of merchandise categories with higher gross profit rates, such as home, apparel and seasonal merchandise, as we become increasingly able to improve our merchandise assortments and stock our stores with more current inventory. Achievement of our gross profit targets is contingent upon this expected sales mix improvement as well as effective inventory management and reductions in inventory shrink and damages.

In addition to the strategic initiatives discussed above, we are now increasingly focused on generating increased cash flows and improving profitability and we are in the early stages of implementing certain targeted retail practices which are expected to positively impact our gross profit, sales productivity and capital efficiency, including:

- Better merchandising and category management, SKU rationalization and space reallocation with an increased focus on gross margin, returns per square foot and shrink reduction;

- Optimizing our real estate strategies by establishing a comprehensive real estate review program based on new processes and technology directed with a more disciplined approach;

- Implementing zone pricing across our store base;

- Increasing foreign direct sourcing;

- Increasing private label penetration with greater consistency; and

- Improving distribution and transportation logistics.

Results of Operations

The following table contains results of operations data for the first 13 weeks of each of 2007 and 2006, and the dollar and percentage variances among those periods:

	13 Weeks Ended		*2007 vs. 2006*	
(amounts in millions, excluding per share amounts)	May 4, 2007	May 5, 2006	*Amount change*	*% change*
Net sales by category:				
Highly consumable	$ 1,523.8	$ 1,456.0	$ *67.8*	*4.7%*
% of net sales	*66.97%*	*67.68%*		
Seasonal	336.4	309.6	*26.9*	*8.7*
% of net sales	*14.79%*	*14.39%*		
Home products	215.0	211.7	*3.4*	*1.6*
% of net sales	*9.45%*	*9.84%*		
Basic clothing	200.0	174.2	*25.8*	*14.8*
% of net sales	*8.79%*	*8.10%*		
Net sales	$ 2,275.3	$ 2,151.4	$ *123.9*	*5.8%*
Cost of goods sold	1,642.2	1,567.1	*75.1*	*4.8*
% of net sales	*72.18%*	*72.84%*		
Gross profit	633.1	584.3	*48.8*	*8.3*
% of net sales	*27.82%*	*27.16%*		
Selling, general and administrative	577.7	503.0	*74.7*	*14.9*
% of net sales	*25.39%*	*23.38%*		
Operating profit	55.4	81.3	*(25.9)*	*(31.9)*
% of net sales	*2.43%*	*3.78%*		
Interest income	(2.6)	(2.5)	*(0.1)*	*5.0*
% of net sales	*(0.11)%*	*(0.11)%*		
Interest expense	6.2	7.2	*(1.1)*	*(14.9)*
% of net sales	*0.27%*	*0.34%*		
Income before income taxes	51.8	76.5	*(24.7)*	*(32.3)*
% of net sales	*2.28%*	*3.56%*		
Income taxes	16.9	28.8	*(11.9)*	*(41.4)*
% of net sales	*0.74%*	*1.34%*		
Net income	$ 34.9	$ 47.7	$ *(12.8)*	*(26.8)%*
% of net sales	*1.53%*	*2.22%*		
Diluted earnings per share	$ 0.11	$ 0.15	$ *0.04*	*(26.7)%*
Weighted average diluted shares	315.9	315.2	*0.7*	*0.2*

13 WEEKS ENDED MAY 4, 2007 AND MAY 5, 2006

Net Sales. The $123.9 million increase in net sales resulted from opening 104 net new stores since May 5, 2006, and a same-store sales increase of 2.4% for the 2007 period compared to the 2006 period. The increase in same-store sales accounted for approximately $50.3 million of the increase in sales while stores opened since the end of the first quarter of 2006 were the primary contributor to the remaining $73.6 million sales increase during the 2007 period.

We monitor our sales internally by the four major categories noted above: highly consumable, seasonal, home products and basic clothing. Generally, over the past several years, sales in the highly consumable category have become a greater percentage of our overall sales mix while the sales of home products and basic clothing have declined as a percentage of total

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sales, which has had a negative impact on our gross profit. We believe the shift has been caused in part by changes in customers' needs and also by our efforts to attract and retain customers by broadening consumable product offerings and including more recognizable brands. We are pleased with the sales of our higher margin seasonal and basic clothing categories in the first quarter of 2007, recognizing that these increases were aided by markdowns taken in connection with our efforts to eliminate packaway inventories and to sell through new merchandise in the current season. 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 among the four categories is an integral part of achieving our gross profit and sales goals.

A portion of our same-store sales increase in the 2007 period compared to the 2006 period was attributable to increased sales in the highly consumable, seasonal, and basic clothing categories, which had overall increases of $67.8 million, or 4.7%, $26.9 million, or 8.7%, and $25.8 million, or 14.8%, respectively. Same-store sales were also positively impacted by an increase in the average dollar value of transactions during the period. We believe that future same-store sales growth is dependent upon an increase in the number of customer transactions as well as an increase in the dollar value of the average transaction.

Gross Profit. Our gross profit rate, as a percent of sales, increased by 66 basis points in the 2007 period as compared with the 2006 period due to a number of factors, including but not limited to: an increase in markups on purchases during the period; a reduction in receipts during the 2007 period as compared to the 2006 period in the highly consumable category, which generally has lower average markups; and higher sales (as a percentage of total sales) in our seasonal and basic clothing categories, which generally have higher average markups. These factors were partially offset by lower average markups on our beginning inventory in the 2007 period as compared with the 2006 period, and an increase in our shrink rate, expressed in retail dollars as a percentage of sales, to 3.64% in the 2007 period compared to 3.31% in the 2006 period. The gross profit rate was also unfavorably impacted by higher markdowns in the 2007 period, which were partially offset by a reduction of our lower of cost or market inventory impairment estimate at the end of the first quarter of 2007.

Selling, General and Administrative ("SG&A") Expense. The increase in SG&A expense as a percentage of sales in the 2007 period as compared with the 2006 period was due to a number of factors, including but not limited to increases in the following expense categories: lease contract termination costs (increased $15.1 million) due primarily to the closing of 153 stores in the current year period related to the strategic real estate initiatives discussed above; professional fees (increased 193.7%) due primarily to fees associated with the proposed Merger and strategic initiatives; repairs and maintenance (increased 47.7%) due to increased store maintenance, including activity associated with the strategic initiatives; a $5.1 million increase in SG&A expenses resulting from hurricane-related insurance recoveries during the prior year period; incentive compensation expense (increased 88.7%) which is based upon our operating performance and changes to our 2007 bonus plan; health benefits costs (increased 46.0%) due primarily to increased claims; and store occupancy costs (increased 9.1%) primarily due to rising average monthly rentals associated with our leased store locations. These increases were partially offset by a 9.1% reduction in insurance costs primarily related to workers' compensation due to the impact of changes in estimate of loss development factors and a 3.1% decline in depreciation and amortization expense due primarily to reduced depreciation on leasehold improvements.

Interest Income. Interest income was relatively constant in the 2007 period compared to the 2006 period, as increased earnings on short-term investments of approximately $0.9 million, primarily due to higher average investment balances, were offset by a $0.9 million decline in interest income in 2007 compared to 2006 due to the second quarter 2006 acquisition of the entity which held legal title to and from which we formerly leased the South Boston distribution center ("DC"), and the related elimination of the notes receivable which represented debt issued by this entity.

Interest Expense. The decrease in interest expense in the 2007 period compared to the 2006 period is due primarily to a decrease of $1.2 million on financing obligations which were related to the acquisition of the South Boston DC and were eliminated in 2006 as described above and a decrease in interest related to income tax contingencies of $1.0 million which, subsequent to the adoption of FIN 48, is now included in income tax expense. In the 2006 period, we increased our interest expense related to income tax contingencies in response to changes in anticipated state tax audit settlements. These decreases were partially offset by a reduction in capitalized interest expense of $1.2 million.

Income Taxes. The effective income tax rate for the 13-week period ended May 4, 2007 was 32.6%, or 5.1% lower than the rate of 37.7% for the 13-week period ended May 5, 2006. The decrease in the effective income tax rate was primarily due to the following: an approximate 1.2% decrease as a result of the renewal, in late 2006, of the federal laws which allow us to claim federal job credits for certain newly hired employees; and an approximate decrease of 6.3% in the 2007 period related to the settlement of income tax contingencies that did not occur in the 2006 period. These decreases were partially offset by the following items which increased the effective income tax rate: an approximate 0.7% increase due principally to state income tax expense resulting from state law changes in the States of New York and Texas; an approximate 0.1% increase due to lower state job related tax credits (principally job credits earned in 2006 for our South Carolina distribution center that did not reoccur in 2007); an increase of approximately 1.7% due to the post-FIN 48 inclusion of income tax related interest expense in the amount reported as income tax expense in 2007; and an increase of approximately 0.7% related to non-deductible expenses incurred in connection with the proposed Merger.

Recently Adopted Accounting Standard

We adopted the provisions of FIN 48 effective February 3, 2007. The adoption resulted in an $8.9 million decrease in retained earnings and a reclassification of certain amounts between deferred income taxes and other noncurrent liabilities to conform to the balance sheet presentation requirements of FIN 48. As of the date of adoption, the total reserve for uncertain tax benefits was $77.9 million. This reserve excludes the federal income tax benefit for the uncertain tax positions related to state income taxes which is now included in deferred tax assets. As a result of the adoption of FIN 48, the reserve for interest expense related to income taxes was increased to $15.3 million and a reserve for potential penalties of $1.9 million related to uncertain income tax positions was recorded. As of the date of adoption, approximately $27.1

million of the reserve for uncertain tax positions would impact our effective income tax rate if we were to recognize the tax benefit for these positions.

Subsequent to the adoption of FIN 48, the Company has elected to record income tax related interest and penalties as a component of the provision for income tax expense.

Liquidity and Capital Resources

Current Financial Condition / Recent Developments. At May 4, 2007, we had total debt (including the current portion of long-term obligations) of $267.6 million and $204.4 million of cash and cash equivalents, compared with total debt of $270.0 million and $189.3 million of cash and cash equivalents at February 2, 2007. Our net debt position remained relatively constant during the first 13 weeks of 2007 due to the factors outlined below.

Our inventory balance represented approximately 47% of our total assets as of May 4, 2007. Our proficiency in managing our inventory balances can have a significant impact on our cash flows from operations during a given period or fiscal year. In addition, inventory purchases can be somewhat seasonal in nature, such as the purchase of warm-weather or Christmas-related merchandise. Inventory turns, calculated on a rolling annualized basis using balances from each quarter, were 4.3 times for the period ended May 4, 2007 compared to 4.1 times for the period ended May 5, 2006 (a 53-week period).

As described in Note 6 to the Condensed 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. We also have certain income tax-related contingencies as more fully described below under “Critical Accounting Policies and Estimates”. Estimates of these contingent liabilities are included in our Condensed Consolidated Financial Statements. However, future negative developments could have a material adverse effect on our liquidity.

We have a credit facility with a maximum commitment of $400 million (with the ability to increase to $500 million upon our mutual agreement with the lenders) that expires in June 2011. In addition to revolving loans, the credit facility includes a $15 million swingline loan sub-limit and a $75 million letter of credit sub-facility. Outstanding swingline loans and letters of credit reduce the borrowing capacity under the credit facility. At May 4, 2007, we had no outstanding borrowings and $23.8 million in letters of credit outstanding under the credit facility and were in compliance with all financial covenants contained in the credit facility.

We have $200 million (principal amount) of 8 5/8% unsecured notes due June 15, 2010. This indebtedness was incurred to assist in funding our growth. Interest on the notes is payable semi-annually on June 15 and December 15 of each year. On June 4, 2007, we announced that Merger Sub has commenced a cash tender offer to purchase any and all of these notes in connection with the anticipated Merger. The tender offer is contingent upon the closing of the Merger.

Significant terms of our outstanding debt obligations could have an effect on our ability to incur additional debt financing. Our credit facility contains financial covenants, which include limits on certain debt to cash flow ratios, a fixed charge coverage test, and minimum allowable consolidated net worth. Our credit facility also places certain specified limitations on secured and unsecured debt. Our outstanding notes discussed above place certain specified limitations on secured debt and place certain limitations on our ability to execute sale-leaseback transactions.

At May 4, 2007 and February 2, 2007, we had commercial letter of credit facilities totaling $200.0 million, of which $57.9 million and $116.1 million, respectively, were outstanding for the funding of imported merchandise purchases.

We believe that our existing cash balances, anticipated cash flows from operations, our credit facility, and our anticipated ongoing access to the capital markets, if necessary, will be sufficient to meet our foreseeable liquidity and capital resource needs.

Cash flows from operating activities. The most significant components of the change in cash flows from operating activities in the 2007 period as compared to the 2006 period were changes in inventory balances, which increased by 1% overall during the first quarter of 2007 compared to an 11% overall increase during the first quarter of 2006. Significant changes in inventory levels occurred in the highly consumable category, which increased by 2% in the 2007 period as compared to a 15% increase in the 2006 period; the seasonal category, which increased by 2% in the 2007 period as compared to a 16% increase in the 2006 period; and the home products category, which declined by 7% in the 2007 period as compared to a 6% increase in the 2006 period. Related to and partially offsetting the changes in inventory balances were offsetting changes in accounts payable balances. The $62.9 million decline in accounts payable balances during the 2007 period was primarily due to a seasonal reduction in import merchandise payables. The decline in net income, as described in more detail above, partially offset the increase in cash flows from operating activities in the 2007 period as compared to the 2006 period.

Cash flows from investing activities. Significant components of property and equipment purchases in the 2007 period included the following approximate amounts: $15 million for new stores; $5 million for improvements and upgrades to existing stores; $3 million for distribution and transportation-related capital expenditures; and $2 million for systems-related capital projects. During the 2007 period, we opened 124 new stores, remodeled 25 stores and relocated 15 stores.

Significant components of our property and equipment purchases in the 2006 period included the following approximate amounts: $22 million for the EZstore project (an initiative designed to improve inventory flow from DCs to consumers); $17 million for new stores; $15 million for distribution and transportation-related capital expenditures; and $9 million for capital projects in existing stores. During the 2006 period, we opened 182 new stores.

Net sales of short-term investments of $6.0 million and purchases of long-term investments of $5.7 million during the 2007 period, and net purchases of short-term and long-term investments of $4.5 million and $10.8 million, respectively, during the 2006 period relate primarily to our captive insurance subsidiary.

Capital expenditures for the 2007 fiscal year are projected to be approximately $180 to $200 million. We anticipate funding our 2007 capital requirements with cash flows from operations and our credit facility, if necessary.

Cash flows from financing activities. We had no borrowings under our credit facility in the 2007 period and borrowings, net of repayments, of $65.0 million during the 2006 period. We repurchased approximately 4.5 million shares of our common stock during the 2006 period at a total cost of $79.9 million. We paid cash dividends of $15.7 million, or $0.05 per share, on outstanding common stock during each of the 2007 and 2006 periods. These uses of cash were offset by proceeds from the exercise of stock options of $34.3 and $10.9 million, respectively, during the 2007 and 2006 periods.

Critical Accounting Policies and Estimates

The preparation of financial statements in accordance with 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. 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, as discussed below, and the utilization of an independent statistician to assist in the LIFO sampling process and index formulation. As part of this process, we also perform an inventory-aging analysis for determining obsolete inventory. Our policy is to write down inventory to an LCM value based on various management assumptions including estimated below-cost markdowns and sales required to liquidate such aged inventory in future periods. Inventory is reviewed on a quarterly basis and adjusted as appropriate to reflect write-downs determined to be necessary. The estimated amount of the below-cost inventory write-downs for the strategic merchandising initiatives discussed above in the “Executive Overview” is based on management’s assumptions regarding the timing and adequacy of markdowns and the final adjustment may vary materially from the estimate depending on various factors, including timing of the execution of the plan, retail market conditions and the accuracy of assumptions used by management in developing these estimates.

Factors such as slower inventory turnover due to changes in competitors’ tactics, 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.

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 shorter of the applicable lease term or the estimated useful life of the asset. The valuation and classification of these assets and the assignment of useful depreciable lives involves significant judgments and the use of estimates.

Impairment of Long-lived Assets. We review the carrying value of all long-lived assets for impairment on an annual basis or more frequently whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. In accordance with Statement of Financial Accounting Standards ("SFAS") 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," we review 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. 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 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 fair value. The fair value is estimated based primarily upon future cash flows (discounted at our credit adjusted risk-free rate) or other reasonable estimates of fair market value.

Insurance Liabilities. We retain a significant portion of the risk for our workers' compensation, employee health insurance, general liability, property loss and automobile coverage. These costs are significant primarily due to the large employee base and number of stores. Provisions are made to this insurance liability on an undiscounted basis based on actual claim data and estimates of incurred but not reported claims developed by independent actuaries utilizing historical claim trends. 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 the Financial Accounting Standards Board ("FASB") Interpretation 48, Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement 109 ("FIN 48"). FIN 48, which was adopted by the Company as of February 3, 2007, requires 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 each quarter 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 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). See Note 6 to the Condensed Consolidated Financial Statements.

Lease Accounting and Excess Facilities. The majority of our stores are subject to short-term leases (usually with initial or primary terms of 3 to 5 years) with multiple renewal options when available. We also have stores subject to build-to-suit arrangements with landlords, which typically carry a primary lease term of between 7 and 10 years with multiple renewal options. Approximately half of our stores have 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. We also receive tenant allowances, which we record as deferred incentive rent and amortize 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 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 SFAS 146, “Accounting 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, as prescribed by SFAS 146. 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. 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. 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 the term that the options are expected to be outstanding, an estimate of the volatility of our stock price, applicable interest rates and the dividend yield of our stock. Other factors involving judgments that affect the expensing of share-based payments include estimated forfeiture rates of share-based awards. 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.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes to the disclosures relating to this item from those set forth in our Annual Report on Form 10-K for the fiscal year ended February 2, 2007.

ITEM 4. CONTROLS AND PROCEDURES

(a) Disclosure Controls and Procedures. We maintain disclosure controls and procedures that are designed to ensure that information relating to us and our consolidated subsidiaries required to be disclosed in our periodic filings under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported in a timely manner in accordance with the requirements of the Exchange Act, and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. We carried out an evaluation, under the supervision and with the participation of management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of these disclosure controls and procedures, as such term is defined in Exchange Act Rule 13a-15(e), as of May 4, 2007. Based on this evaluation, the Chief Executive Officer and the Chief Financial Officer each concluded that our disclosure controls and procedures were effective as of May 4, 2007.

(b) Changes in Internal Control Over Financial Reporting. There have been no changes in our internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) identified in connection with the evaluation of our internal control over financial reporting as required by Exchange Act Rule 13a-15(d) that occurred during the quarter ended May 4, 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information contained in Note 6 to the Condensed Consolidated Financial Statements under the heading "Legal Proceedings" contained in Part I, Item 1 of this Form 10-Q is incorporated herein by this reference.

ITEM 1A. RISK FACTORS

Investing in our securities involves a degree of risk. Persons buying our securities 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. If any of the following risks actually occurs, our business, financial condition, results of operation or cash flows could be materially adversely affected. In any such case, the trading price of our securities could decline and you could lose all or part of your investment. The risks described below are not the only ones facing us and are not intended to be a complete discussion of all potential risks or uncertainties. Additional risks not presently known to us or that we currently deem immaterial may also impair our business operations.

Some of the statements in our reports are not statements of historical fact; instead, they are what are known as "forward-looking statements" that may or may not come to fruition. Certain of the discussions in this report and in the documents incorporated by reference into this report may express or imply projections of revenues or expenditures; plans and objectives for future operations, growth or initiatives (such as the proposed merger; expectations regarding certain planned real estate and merchandising strategic and operational changes and their related timing, charges and cost estimates and anticipated results and benefits; the expected number of new store openings, relocations and remodels; our gross profit rate; the expected sale of inventory and our plans with respect to product assortment, inventory levels and the impact of seasonality; and other potential initiatives and plans referred to in "Results of Operations - Executive Overview"); expected future economic performance; the expected outcome or impact of pending or threatened litigation; our anticipated effective tax rate; or the anticipated levels of borrowings under our amended credit facility and the expected use of those funds. These and similar statements regarding events or results which we expect will or may occur in the future are forward-looking statements concerning matters that involve risks and uncertainties that may cause actual results to differ materially from those projected. Forward-looking statements generally may be identified through the use of words such as "believe," "anticipate," "project," "plan," "expect," "estimate," "objective," "forecast," "goal," "intend," "will likely result," or "will continue" and similar expressions.

Although when we make forward-looking statements we believe they are based on reasonable assumptions within the bounds of our knowledge of our business, a number of factors could cause our actual results to differ materially from those that are projected. Factors and risks that may cause actual results to differ from this forward-looking information include, but are not limited to, those described below, as well as other factors discussed throughout this document, including, without limitation, the factors described under "Critical Accounting Policies and Estimates" or, from time to time, in our SEC filings, press releases and other communications. We cannot assure you that the results or developments expected or anticipated by us will be realized or, even if substantially realized, that those results or developments will result in the expected consequences for us or affect us or our operations in the way that we expect.

There have been no material changes to the risk factors set forth in Part I, Item 1A of the Company's Annual Report on Form 10-K for the fiscal year ended February 2, 2007.

We caution readers to evaluate all forward-looking information in the context of these risks and uncertainties and not to place undue reliance on forward-looking statements made in this document which speak only as of the document's date. We have no obligation, and do not intend, to publicly update or revise any of these forward-looking statements to reflect events or circumstances occurring after the date of this document or to reflect the occurrence of unanticipated events. We advise you, however, to consult any further disclosures we may make on related subjects in the documents we file with or furnish to the SEC or in our other public disclosures. Investors should also be aware that while we do, from time to time, communicate with securities analysts and others, it is against our policy to selectively disclose to them any material nonpublic information or other confidential commercial information. Shareholders should not assume that we agree with any statement or report issued by any analyst regardless of the content of the statement or report. To the extent that reports issued by securities analysts contain any financial projections, forecasts or opinions, those reports are not our responsibility.

General economic factors may adversely affect our financial performance. General economic conditions in one or more of the markets we serve may adversely affect our financial performance. A general slowdown in the economy, higher interest rates, higher fuel and other energy costs, inflation, higher levels of unemployment, higher consumer debt levels, higher tax rates and other changes in tax laws, and other economic factors could adversely affect consumer demand for the products we sell, change our sales mix of products to one with a lower average gross profit and result in slower inventory turnover and greater markdowns on inventory. Higher interest rates, higher commodities rates, higher fuel and other energy costs, transportation costs, inflation, higher costs of labor, insurance and healthcare, foreign exchange rate fluctuations, higher tax rates and other changes in tax laws, changes in other laws and regulations and other economic factors increase our cost of sales and operating, selling, general and administrative expenses, and otherwise adversely affect the operations and operating results of our stores.

Our plans depend significantly on initiatives designed to improve the efficiencies, costs and effectiveness of our operations, and failure to achieve or sustain these plans could affect our performance adversely. We have had, and expect to continue to have, initiatives (such as those relating to marketing, advertising, merchandising, promotions and real estate) in various stages of testing, evaluation, and implementation, upon which we expect to rely to improve our results of operations and financial condition. 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. Testing and general implementation also can be affected by other risk factors described herein that reduce the results expected. 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. Please reference the discussion of the initiatives in the "Executive Overview" portion of Management's Discussion and Analysis.

Because our business is moderately seasonal, with the highest portion of sales occurring during the fourth quarter, adverse events during the fourth quarter could materially

affect our financial statements as a whole. We generally recognize a significant portion of our net sales and net income 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. A seasonal merchandise inventory imbalance could result if for any reason our net sales during the Christmas selling season were to fall below either seasonal norms or expectations. If for any reason our fourth quarter results were substantially below expectations, our profitability 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.

We face intense competition that could limit our growth opportunities and reduce our profitability. The retail business is highly competitive. We operate in the discount retail merchandise business, which is highly 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 reduced profitability because of the lower prices, and thus the lower margins, required to maintain our competitive position. Also, companies operating in the discount retail merchandise sector (due to customer demographics and other factors) have limited ability to increase prices in response to increased costs (including vendor price increases). This limitation may adversely affect our margins and profitability. 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, drug, convenience, variety and specialty stores, supermarkets and supercenter-type stores. Certain of our competitors have greater financial, distribution, marketing and other resources than we do. These other competitors compete in a variety of 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.

Although the retail industry as a whole is highly fragmented, certain segments of the retail industry have recently undergone and continue to undergo some consolidation, which can significantly alter the competitive dynamics of the retail marketplace. This consolidation may result in competitors with greatly improved financial resources, improved access to merchandise, greater market penetration and other improvements in their competitive positions. These business combinations could result in the provision of a wider variety of products and services at competitive prices by these consolidated companies, which 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. 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 the “dollar store” industry in a significant way. Generally, we expect an increase in competition.

Natural disasters, unusually adverse weather conditions, pandemic outbreaks, boycotts and geo-political events could adversely affect our financial performance. The occurrence of one or more natural disasters, such as hurricanes and earthquakes, unusually adverse weather conditions, pandemic outbreaks, boycotts and geo-political events, such as civil unrest in countries in which our suppliers are located and acts of terrorism, or similar disruptions could adversely affect our operations and financial performance. These events could result in physical damage to one or more of our properties, increases in fuel (or other energy) prices, the temporary or permanent closure of one or more of our stores or DCs, 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 local and overseas suppliers, the temporary disruption in the transport of goods from overseas, delay in the delivery of goods to our DCs or stores, the temporary reduction in the availability of products in our stores and disruption to our information systems. These events also can have indirect consequences such as increases in the costs of insurance following a destructive hurricane season. These factors could otherwise disrupt and adversely affect our operations and financial performance.

Risks associated with 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. Political and economic instability in the countries in which foreign suppliers are located, the financial instability of suppliers, suppliers' failure to meet our supplier standards, labor problems experienced by our suppliers, the availability of raw materials to suppliers, merchandise quality issues, currency exchange rates, transport availability and cost, inflation, and other factors relating to the suppliers and the countries in which they are located are beyond our control. 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. In addition, 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 may be required to respond to claims or complaints from customers as if we were the manufacturer of the products. As we increase our imports of merchandise from foreign vendors, the risks associated with foreign imports will increase.

We are dependent on attracting and retaining qualified employees while also controlling labor costs. Our future performance depends on our ability to attract, retain and motivate qualified employees. Many of these employees are in entry-level or part-time positions with historically high rates of turnover. Availability of personnel varies widely from location to location. Our ability to meet our labor needs generally, including our ability to find qualified personnel to fill positions that become vacant at our existing stores and DCs, while controlling our labor costs, is subject to numerous external factors, including the availability of a sufficient number of qualified persons in the work force of the markets in which we are located, unemployment levels within those markets, prevailing wage rates and changes in minimum wage laws, changing demographics, health and other insurance costs and changes in employment legislation. Increased turnover also can have significant indirect costs, including more recruiting and training needs, store disruptions due to management changeover and potential delays in new store openings or adverse customer reactions to inadequate customer service levels due to personnel shortages. Competition for qualified employees exerts upward pressure on wages paid to attract such personnel.

Also, our stores are decentralized and are managed through a network of geographically dispersed management personnel. Our inability to effectively and efficiently operate our stores, including the ability to control losses resulting from inventory and cash shrinkage, may negatively affect our sales and/or operating margins.

Our planned future growth will be impeded, which would adversely affect sales, if we cannot open new stores on schedule or if we close a number of stores materially in excess of anticipated levels. Our growth is dependent on both increases in sales in existing stores and the ability to open new stores. Our ability to timely open new 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 favorable lease terms; the ability to hire and train new personnel, especially store managers; the ability to identify customer demand in different geographic areas; general economic conditions; and the availability of sufficient funds for expansion. In addition, many of these factors affect our ability to successfully relocate stores. Many of these factors are beyond our control. 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 from existing stores, could materially adversely affect our growth. 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 or expanding profitably.

Some of our new stores may be located in areas where we have little or no meaningful experience. 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.

Some 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 cause us to over-saturate markets and temporarily or permanently divert customers and sales from our existing stores, thereby adversely affecting our overall profitability.

We are dependent upon the smooth functioning of our distribution network, the capacity of our DCs, and the timely receipt of inventory. We rely upon the ability to replenish depleted inventory through deliveries to our DCs from vendors and from the DCs to our stores by various means of transportation, including shipments by sea and truck. Labor shortages in the transportation industry could negatively affect transportation costs. In addition, long-term disruptions to the national and international transportation infrastructure that lead to delays or interruptions of service would adversely affect our business.

The efficient operation of our business is heavily dependent upon our information systems. We depend on a variety of information technology systems for the efficient functioning of our business. We rely on certain software vendors to maintain and 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 or with maintenance or adequate support of existing systems could also disrupt or reduce the efficiency of our operations. We also rely heavily on our information technology staff. If we cannot meet our staffing needs in this area, we may not be able to fulfill our technology initiatives while continuing to provide maintenance on existing systems.

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 profitability. Our business is subject to numerous federal, state and local regulations. Changes in these regulations, particularly those governing the sale of products, may require extensive system and operating changes that may be difficult to implement and could increase our cost of doing business. 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.

Our current insurance program may expose us to unexpected costs and negatively affect our profitability. Historically, our insurance coverage has reflected 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, 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 amounts of expense than expected under these programs, which could have a material adverse effect on our financial condition and results of operations. Although we continue to maintain property insurance for catastrophic events, we are effectively self-insured for losses up to the amount of our deductibles. If we experience a greater number of these losses than we anticipate, our profitability could be adversely affected.

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, shareholders, government agencies, or others through private actions, class actions, administrative proceedings, regulatory actions or other litigation. The outcome of litigation, particularly class action lawsuits and regulatory actions, 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. Please see Note 6 to the consolidated financial statements for further details regarding certain of these pending matters.

In addition, from time to time, third parties may claim that our trademarks or product offerings infringe upon their proprietary rights. Any such claim, whether or not it has merit, could be time-consuming and distracting for executive management, result in costly litigation, cause changes to our private label offerings or delays in introducing new private label offerings, or require us to enter into royalty or licensing agreements. As a result, any such claim could have a material adverse effect on our business, results of operations and financial condition.

Our credit facility and other debt instruments place financial and other restrictions on us. Our debt obligations and financings have certain financial covenants and limits on our ability to incur additional indebtedness, to sell assets and to make certain payments. The lender's ongoing obligation to extend credit under these financings will depend upon our compliance with these and other covenants. In addition, we may need to incur additional indebtedness which may have important consequences, including placing us at a competitive disadvantage compared to our competitors that may have proportionately less debt, limiting our flexibility in planning for changes in our business and the industry and making us more vulnerable to economic downturns and adverse developments in our business.

Our profitability could decline if we substantially exceed our anticipated borrowings under our amended credit facility. The amount of borrowings under our amended credit facility may fluctuate materially, particularly given the seasonality of our business, depending on various factors, including the time of year, our need to acquire merchandise inventory, changes to our merchandising plans and initiatives, changes to our capital expenditure plans and the occurrence of other events or transactions that may require funding through the amended credit facility. If these borrowings under our amended credit facility exceed our anticipated levels, our interest expense would increase beyond our expectations and a decrease in our profitability could result.

Our annual and quarterly operating results may fluctuate significantly and could fall below the expectations of securities analysts and investors due to a number of factors, some of which are beyond our control, resulting in a decline in the price of our securities. Our annual and quarterly operating results may fluctuate significantly because of several factors, including those described above. Accordingly, results for any one quarter are not necessarily indicative of results to be expected for any other quarter or for any year, and revenues and net income for any particular future period may decrease. In the future, operating results may fall below the expectations of securities analysts and investors. In that event, the price of our securities could decrease.

Failure to complete the proposed merger could adversely affect us. On March 11, 2007, we entered into a merger agreement with affiliates of Kohlberg Kravis Roberts & Co. L.P.

("KKR"). There is no assurance that the merger agreement and the merger will be approved by our shareholders or that the other conditions to the completion of the merger will be satisfied. The current market price of our common stock may reflect a market assumption that the merger will be completed, and a failure to complete the merger could result in a decline in the market price of our common stock. Consummation of the merger is subject to the following risks:

· the occurrence of any event, change or other circumstances that could give rise to a termination of the merger agreement;

· the outcome of any legal proceedings that have been or may be instituted against us, members of our Board of Directors and others relating to the merger agreement, including the terms of any settlement of such legal proceedings that may be subject to court approval;

· the inability to complete the merger due to the failure to obtain shareholder approval or the failure to satisfy other conditions to consummation of the merger;

· the failure by KKR or its affiliates to obtain the necessary debt financing arrangements set forth in the commitment letter received in connection with the merger; and

· the failure of the merger to close for any other reason.

In addition, in connection with the merger we will be subject to several risks, including the following:

· there may be substantial disruption to our business and a distraction of our management and employees from day-to-day operations, because matters related to the merger may require substantial commitments of their time and resources;

· uncertainty about the effect of the merger may adversely affect our credit rating and our relationships with our employees, suppliers and other persons with whom we have business relationships;

· certain costs relating to the merger, such as legal, accounting and financial advisory fees, are payable by us whether or not the merger is completed; and

· under certain circumstances, if the merger is not completed, we may be required to pay the buyer a termination fee of up to $225 million.

Provisions in our charter, Tennessee law and our shareholder rights plan may discourage potential acquirors of our company, which could adversely affect the value of our securities. Our charter contains provisions that may have the effect of making it more difficult for a third party to acquire or attempt to acquire control of our company. In addition, we are subject to certain provisions of Tennessee law that limit, in some cases, our ability to engage in certain business combinations with significant shareholders. Also, our shareholder rights plan may inhibit accumulations of substantial amounts of our common stock without the approval of our Board of Directors.

These provisions, either alone, or in combination with each other, give our current directors and executive officers a substantial ability to influence the outcome of a proposed acquisition of our company. These provisions would apply even if an acquisition or other significant corporate transaction was considered beneficial by some of our shareholders. If a change in control or change in management is delayed or prevented by these provisions, the market price of our securities could decline.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table contains information regarding purchases of the Company's common stock made during the quarter ended May 4, 2007 by or on behalf of the Company 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 (b)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (b)
02/03/07-02/28/07	232	$17.16	-	$500,000,000
03/01/07-03/31/07	629	$21.18	-	$500,000,000
04/01/06-05/04/07	4,201	$21.15	-	$500,000,000
Total	5,062	$20.97	-	$500,000,000

(a) Includes 891 shares purchased in open market transactions in satisfaction of our obligations under certain employee benefit plans and 4,171 shares accepted in lieu of cash to pay employee tax liabilities upon lapse of restrictions on restricted stock.

(b) On November 29, 2006, we announced that our Board of Directors had approved a share repurchase program of up to $500 million of outstanding shares of our common stock. Under the authorization, purchases may be made in the open market or in privately negotiated transactions from time to time subject to market conditions. This repurchase authorization expires on December 31, 2008.

ITEM 6. EXHIBITS

See Exhibit Index immediately following the signature page hereto, which Exhibit Index is incorporated by reference as if fully set forth herein.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized, both on behalf of the Registrant and in his capacity as principal financial and accounting officer of the Registrant.

DOLLAR GENERAL CORPORATION

Date: June 7, 2007	By:	/s/ David M. Tehle David M. Tehle Executive Vice President and Chief Financial Officer

EXHIBIT INDEX

10.1	Agreement and Plan of Merger, dated as of March 11, 2007, by and among Buck Holdings, L.P., Buck Acquisition Corp., and Dollar General Corporation (incorporated by reference to the Company's Current Report on Form 8-K dated March 12, 2007, filed March 12, 2007).
10.2	Second Amendment to Rights Agreement, dated as of March 12, 2007, between Dollar General Corporation and Registrar and Transfer Company, as Rights Agent (incorporated by reference to the Company's Current Report on Form 8-K dated March 13, 2007, filed March 13, 2007).
10.3	Dollar General Corporation 2007 TeamShare Bonus Program for Named Executive Officers.
10.4	Form of Restricted Stock Unit Award Agreement and Election Forms in connection with restricted stock unit grants made to outside directors pursuant to the Dollar General Corporation 1998 Stock Incentive Plan.
31	Certifications of CEO and CFO under Exchange Act Rule 13a-14(a).
32	Certifications of CEO and CFO under 18 U.S.C. 1350.