DOLLAR GENERAL CORP
Form 10-K
March 28, 2008

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

FORM 10-K

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

For the fiscal year ended February 1, 2008

Commission file number: 001-11421

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

TENNESSEE (State or other jurisdiction of incorporation or organization)	61-0502302 (I.R.S. Employer Identification No.)

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

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

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

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

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

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

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

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

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

Large accelerated filer	[ ]	Accelerated filer	[ ]
Non-accelerated Filer	[X]	Smaller reporting company	[ ]

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

The aggregate fair market value of the registrant’s common stock outstanding and held by non-affiliates as of August 3, 2007 was $663,400, all of which was owned by employees of the registrant and not traded on a public market. For this purpose, directors, executive officers and greater than 10% record shareholders are considered the affiliates of the registrant.

The registrant had 555,481,897 shares of common stock outstanding on March 17, 2008.

INTRODUCTION

General

This report contains references to years 2008, 2007, 2006, 2005, 2004 and 2003, which represent fiscal years ending or ended January 30, 2009, February 1, 2008, February 2, 2007, February 3, 2006, January 28, 2005, and January 30, 2004, respectively. All of the discussion and analysis in this report should be read with, and is qualified in its entirety by, the Consolidated Financial Statements and related notes.

Forward Looking Statements

“Forward-looking statements” within the meaning of the federal securities laws are included throughout this report, particularly under the headings “Business” and “Management’s Discussion and Analysis of Financial Condition and Results of Operation,” among others. You can identify these statements because they are not solely statements of historical fact or they use words such as “may,” “will,” “should,” “expect,” “believe,” “anticipate,” “project,” “plan,” “expect,” “objective,” “forecast,” “goal,” “intend,” “will likely result,” or “will continue” and similar expressions that concern our strateg plans or intentions. For example, all statements relating to our estimated and projected earnings, costs, expenditures, cash flows and financial results, our plans and objectives for future operations, growth or initiatives, or the expected outcome or impact of pending or threatened litigation are forward-looking statements.

All forward-looking statements are subject to risks and uncertainties that may change at any time, so our actual results may differ materially from those that we expected. We derive many of these statements from our operating budgets and forecasts, which are based on many detailed assumptions that we believe are reasonable. However, it is very difficult to predict the impact of known factors, and we cannot anticipate all factors that could affect our actual results. Important factors that could cause actual results to differ materially from the expectations expressed in our forward-looking statements are disclosed under “Risk Factors” in Part I, Item 1A and elsewhere in this document (including, without limitation, in conjunction with the forward-looking statements themselves and under the heading “Critical Accounting Policies and Estimates”). All written and oral forward-looking statements we make in the future are expressly qualified in their entirety by these cautionary statements as well as other cautionary statements that we make from time to time in our other SEC filings and public communications. You should evaluate all of our forward-looking statements in the context of these risks and uncertainties.

The important factors referenced above may not contain all of the material factors that are important to you. In addition, we cannot assure you that we will realize the results or developments we expect or anticipate or, even if substantially realized, that they will result in the consequences or affect us or our operations in the way we expect. The forward-looking statements included in this report are made only as of the date hereof. We undertake no obligation to publicly update or revise any forward-looking statement as a result of new information, future events or otherwise, except as otherwise required by law.

PART I

ITEM 1. BUSINESS

General

We are the largest discount retailer in the United States by number of stores, with 8,222 stores located in 35 states, primarily in the southern, southwestern, midwestern and eastern United States, as of February 29, 2008. We serve a broad customer base and offer a focused assortment of everyday items, including basic consumable merchandise and other home, apparel and seasonal products. A majority of our products are priced at $10 or less and approximately 30% of our products are priced at $1 or less.

We offer a compelling value proposition for our customers based on convenient store locations, easy in and out shopping and quality name brand and private label merchandise at highly competitive everyday low prices. We believe our combination of value and convenience distinguishes us from other discount, convenience and drugstore retailers, who typically focus on either value or convenience. Our business model is focused on strong and sustainable sales growth, attractive margins and limited maintenance capital expenditure and working capital needs, which results in significant cash flow from operations (before interest).

We were founded in 1939 as J.L. Turner and Son, Wholesale. We opened our first dollar store in 1955, when we were first incorporated as a Kentucky corporation under the name J.L. Turner & Son, Inc. We changed our name to Dollar General Corporation in 1968 and reincorporated as a Tennessee corporation in 1998.

We have expanded rapidly in recent years, increasing our total number of stores from 5,540 as of February 1, 2002, to 8,229 as of February 2, 2007, an 8.2% compounded annual growth rate ("CAGR"). Over the same period, we grew our net sales from $5.3 billion to $9.2 billion (11.5% CAGR), driven by growth in number of stores as well as same store sales growth. In the fourth quarter of fiscal 2006, we announced our plans to slow new store growth in 2007 and to close approximately 400 stores in order to improve our profitability and to enable us to focus on improving the performance of existing stores. In 2007, we opened 365 new stores and closed 400 stores. We also relocated or remodeled 300 existing stores. We generated net sales in 2007 of $9.5 billion, an increase of 3.5% over 2006, including a same-store sales increase of 2.1%.

Merger with KKR

On July 6, 2007, we completed a merger (the "Merger") in which our former shareholders received $22.00 in cash, or approximately $6.9 billion in total, for each share of our common stock held. In addition, fees and expenses related to the Merger and the related financing transactions totaling $102.6 million, principally consisting of investment banking fees, management fees, legal fees and stock compensation expense ($39.4 million), are reflected in the 2007 results of operations. As a result of the Merger, we are a subsidiary of Buck Holdings, L.P. ("Parent"), a Delaware limited partnership controlled by investment funds affiliated with Kohlberg Kravis Roberts & Co., L.P. ("KKR" or "Sponsor"). KKR, GS Capital Partners VI

Fund, L.P. and affiliated funds (affiliates of Goldman, Sachs & Co.), Citi Private Equity, Wellington Management Company, LLP, CPP Investment Board (USRE II) Inc., and other equity co-investors (collectively, the "Investors") indirectly own a substantial portion of our capital stock through their investment in Parent.

The Merger consideration was funded through the use of our available cash, cash equity contributions from the Investors, equity contributions of certain members of our management and the debt financings discussed below. Our outstanding common stock is now owned by Parent and certain members of management. Our common stock is no longer registered with the Securities and Exchange Commission ("SEC") and is no longer traded on a national securities exchange.

We entered into the following debt financings in conjunction with the Merger:

- We entered into a credit agreement and related security and other agreements consisting of a $2.3 billion senior secured term loan facility, which matures on July 6, 2014 (the "Term Loan Facility").

- We entered into a credit agreement and related security and other agreements consisting of a senior secured asset-based revolving credit facility of up to $1.125 billion (of which $432.3 million was drawn at closing and $132.3 million was paid down on the same day), subject to borrowing base availability, which matures July 6, 2013 (the "ABL Facility" and, with the Term Loan Facility, the "New Credit Facilities").

- We issued $1.175 billion aggregate principal amount of 10.625% senior notes due 2015, which mature on July 15, 2015, and $725 million aggregate principal amount of 11.875%/12.625% senior subordinated toggle notes due 2017, which mature on July 15, 2017. We repurchased $25 million of the 11.875%/12.625% senior subordinated toggle notes due 2017 in the fourth quarter of fiscal 2007.

Overall Business Strategy

Our mission is "Serving Others." To carry out this mission, we have developed a business strategy of providing our customers with a focused assortment of everyday low priced merchandise in a convenient, small-store format.

Our Customers. In general, we locate our stores and base our merchandise selection on the needs of households seeking value and convenience, with an emphasis on rural and small markets. However, much of our merchandise, intended to serve the basic consumable, household, apparel and seasonal needs of these targeted customers, also appeals to a much broader and higher income customer base.

Our Stores. The traditional Dollar General® store has, on average, approximately 6,900 square feet of selling space and generally serves customers who live within five miles of the store. Of our 8,222 stores operating as of February 29, 2008, more than half serve communities with populations of 20,000 or less. We believe that our target customers prefer the convenience of a small, neighborhood store with a focused merchandise assortment at value prices. Our Dollar General Market® stores are larger than the average Dollar General store, having on average approximately 17,000 square feet of selling space, and carry, among other items, an expanded assortment of grocery products and perishable items. As of February 29, 2008, we operated 57 Dollar General Market stores.

Our Merchandise. Our merchandising strategy combines a low-cost operating structure with a focused assortment of products, consisting of quality basic consumable, household, apparel and seasonal merchandise at competitive everyday low prices. Our strategic combination of name brands, quality private label products and other great value brands allows us to offer our customers a compelling value proposition. We believe our merchandising strategy and focused assortment generate frequent repeat customer purchases and encourage customers to shop at our stores for their everyday household needs.

Our Prices. We distribute quality, consumable merchandise at everyday low prices. Our strategy of a low-cost operating structure and a focused assortment of merchandise allows us to offer quality merchandise at competitive prices. As part of this strategy, we emphasize even-dollar prices on many of our items. In the typical Dollar General store, the majority of the products are priced at $10 or less, with approximately 30% of the products priced at $1 or less.

Our Cost Controls. We aggressively manage our overhead cost structure and typically seek to locate stores in neighborhoods where rental and operating costs are relatively low. Our stores typically have low fixed costs, with lean staffing of usually two to three employees in the store at any time. In 2005 and 2006, we implemented “EZstoreTM”, our initiative designed to improve inventory flow from our distribution centers, or DCs, to consumers. EZstore has allowed us to reallocate store labor hours to more customer-focused activities, improving the work content in our stores.

We also attempt to control operating costs by implementing new technology when feasible, including improvements in recent years to our store labor scheduling and store replenishment systems in addition to other improvements to our supply chain and warehousing systems.

Recent Strategic Initiatives—Project Alpha. In 2007, we executed strategic initiatives launched in the fourth quarter of 2006 aimed at improving our merchandising and real estate strategies, which we refer to collectively as “Project Alpha.” Project Alpha was based upon a comprehensive analysis of the performance of each of our stores and the impact of our inventory management model on our ability to effectively serve our customers.

The execution of this merchandising initiative has moved us away from our traditional inventory packaway model, where unsold seasonal, apparel and home products inventory items were stored on-site and returned to the sales floor to be sold year after year, until the items were eventually sold, damaged or discarded. Project Alpha is an attempt to better meet our customers’ needs and to ensure an appealing, fresh merchandise selection. In connection with this initiative, in fiscal 2007 we began taking end-of-season markdowns on current-year non-replenishable merchandise. With limited and planned exceptions, we eliminated, through end-of-season and other markdowns, our seasonal, home products and basic clothing packaway merchandise and out of season current year merchandise by the end of fiscal 2007. In addition to allowing us to carry newer, fresher merchandise, particularly in our seasonal, apparel and home categories, we believe this strategy change has enhanced the appearance of our stores and will continue to positively impact customer satisfaction as well as our store employees' ability to manage stores.

Project Alpha also encompassed significant improvements to our real estate practices. We are fully integrating the functions of site selection, lease renewals, relocations, remodels and store closings and have defined and are implementing rigorous analytical processes for decision-making in those areas. As a first step in our initiative to revitalize our store base, we performed a comprehensive real estate review resulting in the identification of approximately 400 underperforming stores, all of which we closed by mid-2007. These closings were in addition to stores that are typically closed in the normal course of business, which over the last 10 years constituted approximately 1% to 2% of our store base per year. We believe our rate of store closings should return to historic levels in 2008 and future years. While we believe we have significant opportunities for future store growth, we have moderated our new store growth rate to enable us to focus on improving the performance of existing stores. Those efforts include increasing the number of store remodels and relocations in order to improve productivity and enhance the shopping experience for our customers.

As a result of opening new stores and remodeling existing stores, as of February 29, 2008, over 1,000 stores are operating in our racetrack format, which is designed with improved merchandise adjacencies and wider, more open aisles to enhance the overall guest shopping experience. We plan to continue to enhance this new store layout to further drive sales growth and margin enhancements through improved merchandising.

Our Industry

We compete in the deep discount segment of the U.S. retail industry. Our competitors include traditional "dollar stores," as well as other retailers offering discounted convenience items. The "dollar store" sector differentiates itself from other forms of retailing in the deep discount segment by offering consistently low prices in a convenient, small-store format. Unlike other formats that have suffered with the rise of Wal-Mart and other discount supercenters, the "dollar store" sector has grown despite the presence of the discount supercenters. We believe it is our substantial convenience advantage, at prices comparable to those of supercenters, that allows Dollar General to compete so effectively.

We believe that there is considerable room for growth in the "dollar store" sector. According to AC Nielsen, "dollar stores" have been able to increase their penetration across all income brackets in the last 6 years. Though traditional "dollar stores" have high customer penetration, according to Information Resources, Inc. "IRI," the sector as a whole accounts for only approximately 1.2% of total consumer product goods spending, which we believe leaves ample room for growth. Our merchandising initiatives are aimed at increasing our stores' share of customer spending.

See “Our Competitive Strengths” and “Competition” below for additional information regarding our competitive situation.

Our Competitive Strengths

Market Leader in an Attractive Sector with a Growing Customer Base. We are the largest discount retailer in the U.S. by number of stores, with 8,222 stores in 35 states as of February 29, 2008. We are the largest player in the U.S. small box deep discount segment, with sales in excess of 1.4 times that of our nearest competitor in 2007. We believe we are well positioned to further increase our market share as we continue to execute our business strategy and implement our operational initiatives. Our target customers are those seeking value and convenience. According to Nielsen Media Research as of mid-2007, approximately 64% of households shopped at least once at a discount store (up from 59% in 2001).

Consistent Sales Growth and Strong Cash Flow Generation. For 18 consecutive years, we have experienced positive annual same store sales growth. Approximately two-thirds of our net sales come from the sale of consumable products, which are less susceptible to economic pressures (such as increased fuel costs and unemployment), with the remaining one-third comprised mainly of seasonal, basic clothing and home products which are subject to little trend or fashion risk. We have a low cost operating model with attractive operating margins, low capital expenditures and low working capital needs, resulting in generation of significant cash flow from operations (before interest).

Differentiated Value Proposition. Our ability to deliver highly competitive everyday low prices in a convenient location and shopping format provides our customers with a compelling shopping experience and distinguishes us from other discount retailers, as well as convenience and drugstore retailers.

Compelling Unit Economics. The traditional Dollar General store size, design and location requires an initial investment of approximately $250,000 including inventory. The low initial investment and maintenance capital expenditures, when combined with strong average unit volumes, provide for a quick recovery of store start-up costs. The ability of our stores to generate strong cash flows with minimal investment results in a short payback period.

Efficient Supply Chain. We believe our distribution network is an integral component of our efforts to reduce transportation expenses and effectively support our growth. In recent years, we have made significant investments in technological improvements and upgrades which have increased our efficiency and capacity to support our merchandising and operations initiatives as well as future store growth.

Experienced and Motivated Management Team. In January 2008, we hired Richard Dreiling, who has 38 years of retail experience, to serve as our Chief Executive Officer. Over the past two years we strengthened our management team with the hiring of David Beré, our President and Chief Operating Officer. We also replaced a majority of our senior merchandising and real estate teams. In connection with the Merger, we entered into agreements with certain members of management pursuant to which they elected to invest in Dollar General in an aggregate amount of approximately $10.4 million.

Seasonality

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

The following table reflects the seasonality of net sales, gross profit, and net income (loss) by quarter for each of the quarters of the current fiscal year as well as each of the quarters of the two most recent fiscal years. All of the quarters reflected below are comprised of 13 weeks with the exception of the fourth quarter of our fiscal year ended February 3, 2006, which was comprised of 14 weeks.

(in millions)	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Year Ended February 1, 2008(a)				
Net sales	$ 2,275.3	$ 2,347.6	$ 2,312.8	$ 2,559.6
Gross profit(b)	633.1	623.2	646.8	740.4
Net income (loss)(b)	34.9	(70.1)	(33.0)	55.4
Year Ended February 2, 2007				
Net sales	2,151.4	2,251.1	2,213.4	2,554.0
Gross profit(b)	584.3	611.5	526.4	646.0
Net income (loss)(b)	47.7	45.5	(5.3)	50.1
Year Ended February 3, 2006				
Net sales	1,977.8	2,066.0	2,057.9	2,480.5
Gross profit	563.3	591.5	579.0	730.9
Net income	64.9	75.6	64.4	145.3

(a) For comparison purposes, the 2nd quarter includes the results of operations for Buck Acquisition Corp. for the period prior to the Merger from March 6, 2007 (its formation) through July 7, 2007 (reflecting the change in fair value of interest rate swaps), and the 2nd quarter reflects the combination of pre-Merger and post-Merger results of Dollar General Corporation for the period from May 5, 2007 through August 3, 2007. We believe this presentation provides a more meaningful understanding of the underlying business.

(b) Results for the 3rd and 4th quarters of 2006 and all quarters of 2007 reflect the impact of Recent Strategic Initiatives as discussed in further detail in "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Merchandise

We separate our merchandise into the following four categories for reporting purposes: highly consumable, seasonal, home products, and basic clothing. Highly consumable consists of packaged food, candy, snacks and refrigerated products, health and beauty aids, home cleaning supplies and pet supplies; seasonal consists of seasonal and other holiday-related items, toys, stationery and hardware; and home products consists of housewares and domestics. The percentage of net sales of each of our four categories of merchandise for the period indicated below was as follows:

	2007	2006	2005
Highly consumable	66.5%	65.7%	65.3%
Seasonal	15.9%	16.4%	15.7%
Home products	9.2%	10.0%	10.6%
Basic clothing	8.4%	7.9%	8.4%

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

We currently maintain approximately 5,400 core stock-keeping units, or SKUs, per store and an additional 3,000 non-core SKUs that get rotated in and out of the store over the course of a year. In 2007, we reduced the number of non-core SKUs.

We purchase our merchandise from a wide variety of suppliers. Approximately 12% of our purchases in 2007 were from The Procter & Gamble Company. Our next largest supplier accounted for approximately 6% of our purchases in 2007. We directly imported approximately 9% of our purchases at cost (15% at retail) in 2007.

The Dollar General Store

The average Dollar General store has approximately 6,900 square feet of selling space and is typically operated by a manager, an assistant manager and two or more sales clerks. Approximately 47% of our stores are located in strip shopping centers, 51% are in freestanding buildings and 2% are in downtown buildings. We attempt to locate primarily in small towns or in neighborhoods of more densely populated areas where occupancy expenses are relatively low.

We generally have not encountered difficulty locating suitable store sites in the past, and management does not currently anticipate experiencing material difficulty in finding future suitable locations.

Our recent store growth is summarized in the following table:

Year	Stores at Beginning of Year	Stores Opened	Stores Closed	Net Store Increase/(Decrease)	Stores at End of Year
2005	7,320	734	125(a)	609	7,929
2006	7,929	537	237(b)	300	8,229
2007	8,229	365	400(b)	(35)	8,194

(a) Includes 41 stores closed as a result of hurricane damage.
(b) Includes 128 stores in 2006 and 275 stores in 2007 closed as a result of certain recent strategic initiatives.

Employees

As of February 29, 2008, we employed approximately 71,500 full-time and part-time employees, including divisional and regional managers, district managers, store managers, and DC and administrative personnel. Management believes our relationship with our employees is generally good, and we currently are not a party to any collective bargaining agreements.

Competition

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. We compete with discount stores and with many other retailers, including mass merchandise, grocery, drug, convenience, variety and other specialty stores. These other retail companies operate stores in many of the areas where we operate and many of them engage in extensive advertising and marketing efforts. Our direct competitors in the dollar store retail category include Family Dollar, Dollar Tree, Fred’s, 99 Cents Only and various local, independent operators. Competitors from other retail categories include Wal-Mart Walgreens, CVS, Rite Aid, Target and Costco, among others. Certain of our competitors have greater financial, distribution, marketing and other resources than we do.

The dollar store category differentiates itself from other forms of retailing by offering consistently low prices in a convenient, small-store format. We believe that our prices are competitive due in part to our low cost operating structure and the relatively limited assortment of products offered. Historically, we have minimized labor by offering fewer price points and a reliance on simple merchandise presentation. We maintain strong purchasing power due to our leadership position in the dollar store retail category and our focused assortment of merchandise.

Trademarks

Through our subsidiary, Dollar General Merchandising, Inc., we own marks that are registered with the United States Patent and Trademark Office, including the trademarks Dollar General®, Dollar General Market®, Clover Valley®, American Value®, DG Guarantee® and the Dollar General price point designs, along with certain other trademarks. We attempt to obtain registration of our trademarks whenever practicable and to pursue vigorously any infringement of those marks. Our trademark registrations have various expiration dates; however, assuming that the trademark registrations are properly renewed, they have a perpetual duration.

Available Information

Our Web site address is www.dollargeneral.com. We make available through this address, without charge, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after they are electronically filed or furnished to the SEC.

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. Any of the following risks could materially and adversely affect our business, financial condition or results of operations. In addition, the risks described below are not the only risks facing us. Additional risks and uncertainties not currently known to us or those we currently view to be immaterial also may materially and adversely affect our business, financial condition or results of operations. In any such case, the trading price of our securities could decline or we may not be able to make payments of principal and interest on our outstanding notes, and you may lose all or part of your original investment.

The fact that we have substantial debt could adversely affect our ability to raise additional capital to fund our operations, limit our ability to react to changes in the economy or our industry, expose us to interest rate risk to the extent of our variable rate debt and prevent us from meeting our obligations under our outstanding debt securities.

We have substantial debt which could have important consequences, including:

· making it more difficult for us to make payments on our outstanding debt;

· increasing our vulnerability to general economic and industry conditions;

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

· exposing us to the risk of interest rate fluctuations as certain of our borrowings bear interest based on market interest rates;

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

· limiting our ability to adjust to changing market conditions and placing us at a competitive disadvantage compared to our competitors who are less highly leveraged.

In addition, the borrowings under our New Credit Facilities bear interest at variable rates and other debt we incur also could be variable-rate debt. If market interest rates increase, variable-rate debt will create higher debt service requirements, which could adversely affect our cash flow. While we have and may in the future enter into agreements limiting our exposure to higher interest rates, any such agreements may not offer complete protection from this risk. We and our subsidiaries may be able to incur substantial additional indebtedness in the future, subject to the restrictions contained in our New Credit Facilities and the indentures governing our debt securities. If new indebtedness is added to our current debt levels, the related risks that we now face could intensify.

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

Our New Credit Facilities and the indentures governing our debt securities contain various covenants that limit our ability to engage in specified types of transactions. These covenants limit our and our restricted subsidiaries' ability to, among other things:

· incur additional indebtedness, issue disqualified stock or issue certain preferred stock;

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

· create certain liens or encumbrances;

· sell assets;

· enter into transactions with our affiliates;

· limit the ability of restricted subsidiaries to make payments to us;

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

· designate our subsidiaries as unrestricted subsidiaries.

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

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 than expected fuel and other energy costs, inflation, higher levels of unemployment, higher consumer debt levels, higher tax rates and other changes in tax laws, tightening of the credit markets, 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 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, merchandising, promotions, sourcing, shrink, private label, store operations 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.

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

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

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

The retail business is highly competitive. We operate in the 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 adverse impact to our financial performance 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) may have limited ability to increase prices in response to increased costs (including vendor price increases). This limitation may adversely affect our margins and financial performance. We compete for customers, employees, store sites, products and services and in other important aspects of our business with many other local, regional and national retailers. We compete with retailers operating discount, mass merchandise, grocery, drug, convenience, variety and other specialty 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. See "Business—Our Industry, —Competitive Strengths, and —Competition" for additional discussion of our competitive situation.

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 distribution centers, 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 distribution centers 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. Approximately 12% of our purchases in 2007 were from The Procter & Gamble Company. Our next largest supplier accounted for approximately 6% of our purchases in 2007. We directly imported approximately 9% of our purchases at cost in 2007, but many of our domestic vendors directly import their products or components of their products. 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 or safety issues, currency exchange rates, transport availability and cost, inflation, and other factors relating to the suppliers and the countries in which they are located or from which they import are beyond our control. 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 distribution centers, while controlling our labor costs, is subject to numerous external factors, including the level of competition for such personnel in a given market, 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. In addition, to the extent a significant portion of our employee base unionizes, or attempts to unionize, our labor costs could increase. Our ability to pass along those costs is constrained.

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. In addition, our substantial debt, particularly combined with the recent tightening of the credit markets, has made it more difficult for our real estate developers to obtain loans for our build-to-suit stores and to locate investors for those properties after they have been developed. If this trend continues, it could materially adversely impact our ability to open build-to-suit stores in desirable locations.

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 financial performance.

We are dependent upon the smooth functioning of our distribution network, the capacity of our distribution centers, and the timely receipt of inventory.

We rely upon the ability to replenish depleted inventory through deliveries to our distribution centers from vendors and from the distribution centers to our stores by various means of transportation, including shipments by sea and truck. Labor shortages in the transportation industry and/or labor inefficiencies associated with certain “driver hours of service” regulations adopted by the Federal Motor Carriers Safety Administration 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 our financial performance.

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, in addition to reputational damage.

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

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 financial performance 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. See Part I, Item 3 "Legal Proceedings" 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.

The Investors control us and may have conflicts of interest with us now or in the future.

The Investors indirectly own, through their investment in Parent, a substantial portion of our common stock. As a result, the Investors have control over our decisions to enter into any corporate transaction and have the ability to prevent any transaction that requires the approval of shareholders regardless of whether others believe that any such transactions are in our own best interests. For example, the Investors could cause us to make acquisitions that increase the amount of indebtedness that is secured or that is senior to our outstanding debt securities or to sell assets, which may impair our ability to make payments under our outstanding debt securities.

Additionally, the Investors are in the business of making investments in companies and may from time to time acquire and hold interests in businesses that compete directly or indirectly with us. The Investors may also pursue acquisition opportunities that may be complementary to our business and, as a result, those acquisition opportunities may not be available to us. So long as the Investors, or other funds controlled by or associated with the Investors, continue to indirectly own a significant amount of the outstanding shares of our common stock, even if such amount is less than 50%, the Investors will continue to be able to strongly influence or effectively control our decisions.

ITEM 2. PROPERTIES

As of February 29, 2008, we operated 8,222 retail stores located in 35 states as follows:

State	Number of Stores	State	Number of Stores
Alabama	446	Nebraska	80
Arizona	51	New Jersey	22
Arkansas	224	New Mexico	42
Colorado	19	New York	223
Delaware	24	North Carolina	467
Florida	415	Ohio	465
Georgia	464	Oklahoma	271
Illinois	306	Pennsylvania	393
Indiana	302	South Carolina	316
Iowa	170	South Dakota	12
Kansas	144	Tennessee	403
Kentucky	300	Texas	969
Louisiana	326	Utah	9
Maryland	57	Vermont	3
Michigan	238	Virginia	243
Minnesota	16	West Virginia	149
Mississippi	256	Wisconsin	88
Missouri	309		

Most of our stores are located in leased premises. Individual store leases vary as to their terms, rental provisions and expiration dates. The majority of our leases are relatively low-cost, short-term leases (usually with initial or primary terms of three to five years) often with multiple renewal options. 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. In recent years, an increasing percentage of our new stores have been subject to build-to-suit arrangements. In 2007, approximately 70% of our new stores were build-to-suit arrangements.

As of February 29, 2008, we operated nine distribution centers, as described in the following table:

Location	Year Opened	Approximate Square Footage	Approximate Number of Stores Served
Scottsville, KY	1959	720,000	948
Ardmore, OK	1994	1,310,000	1,147
South Boston, VA	1997	1,250,000	779
Indianola, MS	1998	820,000	885
Fulton, MO	1999	1,150,000	1,093
Alachua, FL	2000	980,000	735
Zanesville, OH	2001	1,170,000	1,113
Jonesville, SC	2005	1,120,000	728
Marion, IN	2006	1,110,000	794

We lease the distribution centers located in Oklahoma, Mississippi and Missouri and own the other six distribution centers. Approximately 7.25 acres of the land on which our Kentucky distribution center is located is subject to a ground lease. We lease additional temporary warehouse space as necessary to support our distribution needs.

Our executive offices are located in approximately 302,000 square feet of leased space in Goodlettsville, Tennessee.

ITEM 3. LEGAL PROCEEDINGS

The information contained in Note 7 to the consolidated financial statements under the heading “Legal proceedings” contained in Part II, Item 8 of this report is incorporated herein by this reference.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of shareholders during the fourth quarter of 2007.

PART II

ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market and Dividend Information. Our outstanding common stock is privately held, and there is no established public trading market for our common stock. There were approximately 145 shareholders of record of our common stock as of March 17, 2008.

Our Board of Directors declared a quarterly dividend in the amount of $0.05 per share:

- payable on or before April 20, 2006 to common shareholders of record on April 6, 2006;

- payable on or before July 20, 2006 to common shareholders of record on July 6, 2006;

· payable on or before October 19, 2006 to common shareholders of record on October 5, 2006;

· payable on or before January 18, 2007 to common shareholders of record on January 4, 2007; and

· payable on or before April 19, 2007 to common shareholders of record on April 5, 2007.

Our Board of Directors did not declare a dividend thereafter. See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources" for a description of the restrictions on our ability to pay dividends.

Unregistered Sales of Equity Securities. In connection with the Merger, our officer-level employees were offered the opportunity to roll over portions of their equity and/or stock options and to purchase additional equity of Dollar General. In connection with such opportunity, on July 6, 2007 these individuals purchased a total of 635,207 shares of common stock having an aggregate value of approximately $3,176,035 and exchanged a total of 2,225,175 stock options outstanding prior to the Merger for 1,920,543 vested options to purchase shares of common stock (the "Rollover Options") in the surviving company (the "Rollover"). The Rollover Options remain outstanding in accordance with the terms of the governing stock incentive plan and grant agreements pursuant to which the holder originally received the stock option grants. However, immediately after the Merger, the exercise price and number of shares underlying the Rollover Options were adjusted as a result of the Merger and the exercise price for all of the options was adjusted to $1.25 per option.

We subsequently offered certain other employees a similar investment opportunity to participate in our common equity. As a result, on September 20, 2007 and October 5, 2007, we sold 15,000 shares and 558,000 shares, respectively, of our common stock to those employees for a purchase price of $5 per share.

In connection with the investment discussed above and the Merger, our Board of Directors adopted a new stock incentive plan pursuant to which certain of our officer-level and other employees also were granted, on July 6, 2007, September 20, 2007 and October 5, 2007, respectively, new non-qualified stock options to purchase 13,110,000 shares, 130,000 shares and 4,150,000 shares of our common stock at a per share exercise price of $5, which represented the fair market value of one share of our common stock on the grant date. Effective January 21, 2008, our Board also granted to our CEO, Mr. Dreiling, non-qualified stock options to purchase 2.5 million shares of our common stock pursuant to the terms of the new stock incentive plan. All of these new options expire no later than 10 years following the grant date. In addition, half of the options will vest ratably on each of the five anniversaries of July 6, 2007 solely based upon continued employment over that time period, while the other half of the options will vest based both upon continued employment and upon the achievement of predetermined performance annual or cumulative financial-based targets over time which coincide with our fiscal year. The options also have certain accelerated vesting provisions upon a change in control or initial public offering, as defined in the new incentive plan.

Effective January 21, 2008, our Board also granted to Mr. Dreiling 890,000 shares of restricted common stock pursuant to the terms of the new stock incentive plan. The restricted stock will vest on the last day of our 2011 fiscal year if Mr. Dreiling remains employed by us through that date. The restricted stock also has certain accelerated vesting provisions upon a change in control, initial public offering, termination without cause or due to death or disability, or resignation for good reason, all as defined in Mr. Dreiling's employment agreement.

The share issuances, the Rollover Options and the new option and restricted stock grants described above were effected without registration in reliance on (1) the exemptions afforded by Section 4(2) of the Securities Act of 1933, as amended (the "Securities Act"), because the sales did not involve any public offering, (2) Rule 701 promulgated under the Securities Act for shares that were sold under a written compensatory benefit plan or contract for the participation of our employees, directors, officers, consultants and advisors, and (3) Regulation S promulgated under the Securities Act relating to offerings of securities outside of the United States.

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth selected consolidated financial information of Dollar General Corporation as of the dates and for the periods indicated. The selected historical statement of operations data and statement of cash flows data for the fiscal years ended February 1, 2008, February 2, 2007 and February 3, 2006, and balance sheet data as of February 1, 2008 and February 2, 2007 have been derived from our historical audited consolidated financial statements included elsewhere in this report. The selected historical statement of operations data and statement of cash flows data for the fiscal years ended January 28, 2005 and January 30, 2004 and balance sheet data as of February 3, 2006, January 28, 2005, and January 30, 2004 presented in this table have been derived from audited consolidated financial statements not included in this report.

As a result of the Merger, purchase accounting, and a new basis of accounting beginning on July 7, 2007, the 2007 financial reporting periods presented below include the 22-week Predecessor period of the Company from February 3, 2007 to July 6, 2007 and the 30-week Successor period, reflecting the merger of the Company and Buck Acquisition Corp. ("Buck") from July 7, 2007 to February 1, 2008. Buck's results of operations for the period from March 6, 2007 to July 6, 2007 (prior to the Merger on July 6, 2007) are also included in the consolidated financial statements for the periods described above, where applicable, as a result of certain derivative financial instruments entered into by Buck prior to the Merger as further described below. Other than these financial instruments, Buck had no assets, liabilities, or operations prior to the Merger. The fiscal years presented from 2003 to 2006 reflect the Predecessor.

Due to the significance of the Merger and related transactions that occurred in 2007, the 2007 Successor financial information may not be comparable to that of previous periods presented in the accompanying table.

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

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

	Successor	Predecessor				
		Fiscal Year Ended				
	July 7, 2007 through February 1, 2008 (1)	February 3, 2007 through July 6, 2007	February 2, 2007 (2)	February 3, 2006 (3)	January 28, 2005	January 30, 2004
Statement of Operations Data:						
Net sales	$ 5,571.5	$ 3,923.8	$ 9,169.8	$ 8,582.2	$ 7,660.9	$ 6,872.0
Cost of goods sold	3,999.6	2,852.2	6,801.6	6,117.4	5,397.7	4,853.9
Gross profit	1,571.9	1,071.6	2,368.2	2,464.8	2,263.2	2,018.1
Selling, general and administrative (4)	1,324.5	960.9	2,119.9	1,903.0	1,706.2	1,510.1
Transaction and related costs	1.2	101.4	-	-	-	-
Operating profit	246.1	9.2	248.3	561.9	557.0	508.0
Interest income	(3.8)	(5.0)	(7.0)	(9.0)	(6.6)	(4.1)
Interest expense	252.9	10.3	34.9	26.2	28.8	35.6
Loss on interest rate swaps	2.4	-	-	-	-	-
Loss on debt retirement, net	1.2	-	-	-	-	-
Income (loss) before taxes	(6.6)	4.0	220.4	544.6	534.8	476.5
Income tax expense (benefit)	(1.8)	12.0	82.4	194.5	190.6	177.5
Net income (loss)	$ (4.8)	$ (8.0)	$ 137.9	$ 350.2	$ 344.2	$ 299.0
Statement of Cash Flows Data:						
Net cash provided by (used in):						
Operating activities	$ 239.6	$ 201.9	$ 405.4	$ 555.5	$ 391.5	$ 514.1
Investing activities	(6,848.4)	(66.9)	(282.0)	(264.4)	(259.2)	(256.7)
Financing activities	6,709.0	25.3	(134.7)	(323.3)	(245.4)	(43.3)
Total capital expenditures	(83.6)	(56.2)	(261.5)	(284.1)	(288.3)	(140.1)
Other Financial and Operating Data:						
Same store sales growth	1.9%	2.6%	3.3%	2.2%	3.2%	4.0%
Number of stores (at period end)	8,194	8,205	8,229	7,929	7,320	6,700
Selling square feet (in thousands at period end)	57,376	57,379	57,299	54,753	50,015	45,354
	$ 165.4	$ 163.9	$ 162.6	$ 159.8	$ 159.6	$ 157.5

Net sales per square foot (5)						
Highly consumable sales	66.4%	66.7%	65.7%	65.3%	63.0%	61.2%
Seasonal sales	16.3%	15.4%	16.4%	15.7%	16.5%	16.8%
Home product sales	9.1%	9.2%	10.0%	10.6%	11.5%	12.5%
Basic clothing sales	8.2%	8.7%	7.9%	8.4%	9.0%	9.5%
Rent expense	$ 214.5	$ 150.2	$ 343.9	$ 312.3	$ 268.8	$ 232.0
Balance Sheet Data (at period end):						
Cash and cash equivalents and short-term investments	$ 119.8		$ 219.2	$ 209.5	$ 275.8	$ 414.6
Total assets	8,656.4		3,040.5	2,980.3	2,841.0	2,621.1
Total debt	4,282.0		270.0	278.7	271.3	282.0
Total shareholders' equity	2,703.9		1,745.7	1,720.8	1,684.5	1,554.3

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

(2)Includes the effects of certain strategic merchandising and real estate initiatives as further described in "Management's Discussion and Analysis of Financial Condition and Results of Operations."

(3)The fiscal year ended February 3, 2006 was comprised of 53 weeks.

(4)Penalty expenses of $10 million in fiscal 2003 are included in SG&A.

(5)For the fiscal year ended February 3, 2006, net sales per square foot was calculated based on 52 weeks' sales.

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

General

Accounting Periods. The following text contains references to years 2008, 2007, 2006 and 2005, which represent fiscal years ending or ended January 30, 2009, February 1, 2008, February 2, 2007 and February 3, 2006, respectively. Our fiscal year ends on the Friday closest to January 31. Each of fiscal years 2007 and 2006 were and fiscal year 2008 will be 52-week accounting periods, while fiscal 2005 was a 53-week accounting period, which affects the comparability of certain amounts in the Consolidated Financial Statements and financial ratios between 2005 and the other fiscal years reflected herein. As discussed below, we completed a merger transaction on July 6, 2007. The 2007 52-week period presented includes the 22-week Predecessor period of Dollar General Corporation through July 6, 2007 reflecting the historical basis of accounting, and a 30-week Successor period, reflecting the impact of the business combination and associated purchase price allocation of the merger of Dollar General Corporation and Buck Acquisition Corp. ("Buck"), from July 7, 2007 to February 1, 2008. For comparison purposes, the discussion of results of operations below is generally based on the mathematical combination of the Successor and Predecessor periods for the 52-week fiscal year ended February 1, 2008 compared to the Predecessor 2006 fiscal year ended February 2, 2007, which we believe provides a meaningful understanding of the underlying business. Transactions relating to or resulting from the Merger are discussed separately. The combined results do not reflect the actual results we would have achieved absent the Merger and should not be considered indicative of future results of operations. This discussion and analysis should be read with, and is qualified in its entirety by, the Consolidated Financial Statements and the notes thereto. It also should be read in conjunction with the Forward-Looking Statements/Risk Factors disclosures set forth in the Introduction and in 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 year to year, and the primary factors that accounted for those changes, as well as how certain accounting principles affect our financial statements.

Merger with KKR

On July 6, 2007, we completed a merger (the "Merger") in which our former shareholders received $22.00 in cash, or approximately $6.9 billion in total, for each share of our common stock held. As a result of the Merger, we are a subsidiary of Buck Holdings, L.P. ("Parent"), a Delaware limited partnership controlled by investment funds affiliated with Kohlberg Kravis Roberts & Co., L.P. ("KKR" or "Sponsor"). KKR, GS Capital Partners VI Fund, L.P. and affiliated funds (affiliates of Goldman, Sachs & Co.), Citi Private Equity, Wellington Management Company, LLP, CPP Investment Board (USRE II) Inc., and other equity co-investors (collectively, the "Investors") indirectly own a substantial portion of our capital stock through their investment in Parent.

The Merger consideration was funded through the use of our available cash, cash equity contributions from the Investors, equity contributions of certain members of our management and the debt financings discussed below. Our outstanding common stock is now owned by Parent and certain members of management. Our common stock is no longer registered with the Securities and Exchange Commission ("SEC") and is no longer traded on a national securities exchange.

We entered into the following debt financings in conjunction with the Merger:

· We entered into a credit agreement and related security and other agreements consisting of a $2.3 billion senior secured term loan facility, which matures on July 6, 2014 (the "Term Loan Facility").

· We entered into a credit agreement and related security and other agreements consisting of a senior secured asset-based revolving credit facility of up to $1.125 billion (of which $432.3 million was drawn at closing and $132.3 million was paid down on the same day), subject to borrowing base availability, which matures July 6, 2013 (the "ABL Facility" and, with the Term Loan Facility, the "New Credit Facilities").

· We issued $1.175 billion aggregate principal amount of 10.625% senior notes due 2015, which mature on July 15, 2015, and $725 million aggregate principal amount of 11.875%/12.625% senior subordinated toggle notes due 2017, which mature on July 15, 2017. During the fourth quarter of fiscal 2007, we repurchased $25 million of the 11.875%/12.625% senior subordinated toggle notes due 2017.

Executive Overview

We are the largest discount retailer in the United States by number of stores, with approximately 8,200 stores located in 35 states, primarily in the southern, southwestern, midwestern and eastern United States. We serve a broad customer base and offer a focused assortment of everyday items, including basic consumable merchandise and other home, apparel and seasonal products. A majority of our products are priced at $10 or less and approximately 30% of our products are priced at $1 or less. We seek to offer a compelling value proposition for our customers based on convenient store locations, easy in and out shopping and quality merchandise at highly competitive prices. We believe our combination of value and convenience distinguishes us from other discount, convenience and drugstore retailers, who typically focus on either value or convenience.

The nature of our business is seasonal to a certain extent. 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.

In November 2006, we completed a strategic review of our inventory and real estate strategies and announced significant changes to existing company practices, which we refer to as “Project Alpha.” At that time, we announced our decision to close 403 stores which did not meet our recently developed store criteria, in addition to stores closed in the ordinary course of business, and to slow our new store growth rate. We made this decision to allow ourselves to focus on our merchandising efforts and improvements to our execution in the stores. At that time, we also announced the decision to eliminate, with limited exceptions, our “packaway” inventory strategy, which was our historical practice of storing unsold merchandise at the end of a season and carrying it over to the following year. All of the 403 stores identified for closing were closed by the end of July 2007, and all of our packaway inventory was eliminated by the end of the 2007 fiscal year. We believe that the elimination of packaway inventory, coupled with the completion in 2006 of the implementation of our EZstoreTM process (simplifying the way we stock new merchandise in our stores), contributed to our ability to show significant improvements in the shopability and manageability of our stores in 2007. We believe these initiatives also led to our successful reduction of store employee turnover in 2007, including significant improvement at the critical store manager and district manager levels.

In addition to the initiatives noted above, during 2007 we worked closely with KKR to refine our strategic initiatives and set goals to improve our operational and financial performance. During this transition, we slowed our store growth, as planned, and we defined very specific operational and financial benchmarks to monitor and measure our progress against our goals. Specifically, in 2007, we focused on and made good progress on improving our merchandising and category management processes, refining our real estate processes and improving our distribution and transportation logistics. In addition, we accelerated our efforts to refine our pricing strategy, increase direct foreign sourcing and expand our private label offering. All of these initiatives are ongoing and we continue to expect them to positively impact our gross profit, sales productivity and capital efficiency in 2008 and beyond.

It is important for you to read our more detailed discussion of financial and operating results below under “Results of Operations.” Basis points or "bps" amounts referred to below are equal to 0.01 percent as a percentage of sales. Some of the more significant highlights of the 2007 fiscal year are as follows:

· Total sales increased 3.5%, including a 2.1% increase in same-store sales compared with the prior year. The remaining sales increase resulted from new stores, partially offset by the impact of closed stores.

· Gross profit, as a percentage of sales, increased to 27.8% compared to 25.8% in 2006. This increase was the result of improved purchase markups, decreased markdowns, and leverage on distribution costs impacted by improved logistics. The 2006 gross profit rate was significantly impacted by merchandise markdowns as a result of our inventory liquidation and store closing activities.

· SG&A, as a percentage of sales, increased to 24.1% compared to 23.1%. Several items of significance affected this comparison, including: the addition of leasehold intangibles amortization (non-cash) of 25 bps; an excess of Project Alpha-related

SG&A expenses in 2007 over 2006 of 21 bps; an excess of 2007 incentive compensation resulting from meeting certain financial targets over 2006 discretionary bonuses of 18 bps; the impact of hurricane-related insurance proceeds received in 2006 of 14 bps; an accrued loss relating to the restructuring of certain distribution center leases as a result of the Merger of 13 bps; and other SG&A relating to or resulting from the Merger.

· Other items affecting our 2007 results of operations, relating to or resulting from the Merger, as more fully described below, include transaction and related costs of $102.6 million and a significant increase in interest expense.

· As a result, we incurred a net loss for the 2007 combined periods of $12.8 million compared to net income for 2006 of $137.9 million. Cash flow from operating activities increased to $441.6 million in 2007 from $405.4 million in 2006.

· We opened 365 new stores, closed 400 stores (including 275 remaining from Project Alpha) and relocated or remodeled 300 stores. As of February 1, 2008, we operated 8,194 stores.

· We also reduced total inventories by $143.7 million, or 10.0%.

We made significant progress on our merchandising and operating initiatives in 2007, including clearing our stores of packaway inventories and closing our low-performing stores, giving us a strong foundation for further enhancements in 2008. These changes also contributed to a decrease in employee turnover and a dramatic improvement in the overall appearance of our stores. We moved forward with our pricing and private label initiatives and enhanced our merchandising analysis tools giving us a better platform for decision-making. We accomplished these goals while making a significant transition in the financial structure of the Company.

2008 Priorities. In 2008, under the leadership of our new CEO, we plan to continue to deliver value to our customers through our ability to deliver highly competitive prices in a convenient shopping format. Our stores provide our customers with a compelling shopping experience, low everyday prices on name brand and other quality items in a convenient, easy-to-shop format. We plan to continue to improve on this value/convenience model by implementing merchandising and operational improvements.

We are focused on further improving financial performance through:

· Productive sales growth, including emphasis on increasing shopper frequency, size of basket and productivity per square foot.

· Improving our gross margins through: decreasing inventory shrink, refining our pricing strategy, optimizing our merchandise offering, expanding and improving our private label offering and improving and expanding our foreign sourcing;

- Improving our operational processes, for example, through information technology and work management and leveraging those improvements to reduce costs.
- Strengthening and expanding our culture of serving others.

In addition, we plan to open approximately 200 new stores and to remodel or relocate approximately 400 stores.

Key Financial Metrics. We have identified the following as our most critical financial metrics for 2008:

- Same-store sales growth / sales per square foot
- Gross profit, as a percentage of sales
- Inventory turnover
- Cash flow
- Earnings before interest, taxes and depreciation and amortization ("EBITDA")

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

Results of Operations

The following discussion of our financial performance is based on the Consolidated Financial Statements set forth herein. The following table contains results of operations data for the 2007, 2006 and 2005 fiscal years, and the dollar and percentage variances among those years.

				2007 vs. 2006		2006 vs. 2005	
(amounts in millions)	2007 (a)	2006 (b)	2005 (c)	$ change	% change	$ change	% change
Net sales by category:							
Highly consumable	$ 6,316.8	$ 6,022.0	$ 5,606.5	$ 294.8	4.9%	$ 415.5	7.4%
% of net sales	66.53%	65.67%	65.33%				
Seasonal	1,513.2	1,510.0	1,348.8	3.2	0.2	161.2	12.0
% of net sales	15.94%	16.47%	15.72%				
Home products	869.8	914.4	907.8	(44.6)	(4.9)	6.5	0.7
% of net sales	9.16%	9.97%	10.58%				
Basic clothing	795.4	723.5	719.2	72.0	9.9	4.3	0.6
% of net sales	8.38%	7.89%	8.38%				
Net sales	$ 9,495.2	$ 9,169.8	$ 8,582.2	$ 325.4	3.5%	$ 587.6	6.8%
Cost of goods sold	6,851.8	6,801.6	6,117.4	50.2	0.7	684.2	11.2
% of net sales	72.16%	74.17%	71.28%				
Gross profit	2,643.5	2,368.2	2,464.8	275.3	11.6	(96.6)	(3.9)
% of net sales	27.84%	25.83%	28.72%				
Selling, general and administrative expenses	2,285.4	2,119.9	1,903.0	165.5	7.8	217.0	11.4
% of net sales	24.07%	23.12%	22.17%				
Transaction and related costs	102.6	-	-	102.6	100.0	-	-
% of net sales	1.08%	-	-			-	-
Operating profit	255.4	248.3	561.9	7.2	2.9	(313.6)	(55.8)
% of net sales	2.69%	2.71%	6.55%				
Interest income	(8.8)	(7.0)	(9.0)	(1.8)	26.3	2.0	(22.2)
% of net sales	(0.09)%	(0.08)%	(0.10)%				
Interest expense	263.2	34.9	26.2	228.3	653.8	8.7	33.1
% of net sales	2.78%	0.38%	0.31%				
	2.4	-	-	2.4	100.0	-	-

Loss on interest rate swaps, net							
% of net sales	0.03%	-	-				
Loss on debt retirements, net	1.2	-	-	1.2	100.0	-	-
% of net sales	0.01%	-	-				
Income (loss) before income taxes	(2.6)	220.4	544.6	(222.9)	(101.1)	(324.3)	(59.5)
% of net sales	(0.03)%	2.40%	6.35%				
Income taxes	10.2	82.4	194.5	(72.2)	(87.6)	(112.1)	(57.6)
% of net sales	0.11%	0.90%	2.27%				
Net income (loss)	$ (12.8)	$ 137.9	$ 350.2	$ (150.7)	(109.3)%	$ (212.2)	(60.6)%

(a) The amounts in the 2007 column represent the mathematical combination of the Predecessor through July 6, 2007 and Successor from July 7, 2007 through February 1, 2008 as included in the consolidated financial statements. These results also include the operations of Buck for the period prior to the Merger from March 6, 2007 (Buck's date of formation) through July 6, 2007 (reflecting the change in fair value of interest rate swaps.) This presentation does not comply with generally accepted accounting principles, but we believe this combination provides a meaningful method of comparison.

(b) Includes the impacts of certain strategic initiatives as more fully described in the "Executive Overview" above.

(c) The fiscal year ended February 3, 2006 was comprised of 53 weeks.

Net Sales. Net sales increased $325.4 million, or 3.5%, in 2007, primarily representing a same-store sales increase of 2.1% for 2007 compared to 2006. Same-store sales include stores that have been open for 13 months and remain open at the end of the reporting period. The increase in same-store sales accounted for $185.6 million of the increase in sales. Sales resulting from new store growth, including 365 new stores in 2007, were partially offset by the impact of store closings in 2007 and 2006. Increased sales of highly consumables accounted for $294.8 million of our total sales increase, resulting from successful changes over the past year to our consumables merchandising mix. Sales of seasonal merchandise and apparel increased slightly and were partially offset by a decrease in home products sales. To some extent, sales in these more discretionary categories were impacted by our efforts to eliminate our packaway strategy by the end of 2007 and to reduce overall inventory levels. In addition, we believe sales of seasonal merchandise, apparel and home products were negatively affected by continued economic pressures on our customers, particularly in the fourth quarter. The increase in same-store sales represents an increase in average customer purchase, offset by a slight decrease in customer traffic.

Increases in 2006 net sales resulted primarily from opening additional stores, including 300 net new stores in 2006, and a same-store sales increase of 3.3% for 2006 compared to 2005. The increase in same-store sales accounted for $265.4 million of the increase in sales, while new stores were the primary contributors to the remaining $322.2 million sales increase during 2006. The increase in same-store sales is primarily attributable to an increase in average customer purchase. We also believe that the strategic merchandising and real estate initiatives discussed above in the “Executive Overview” had a positive impact on net sales in the fourth quarter. By merchandise category, our sales increase in 2006 compared to 2005 was primarily attributable to the highly consumable category, which increased by $415.5 million, or 7.4%. An increase in sales of seasonal merchandise of $161.2 million, or 12.0%, also contributed to overall sales growth. We believe that our increased sales in 2006 were supported by additions to our product offerings and increased promotional activities, including the use of advertising circulars and clearance activities.

As discussed above, we monitor our sales internally by the following four major categories: highly consumable, seasonal, home products and basic clothing. The highly consumable category has a lower gross profit rate than the other three categories and has grown significantly over the past several years. We expect the move away from our packaway inventory strategy to have a positive impact on sales in our non-consumable merchandise categories. Because of the impact of sales mix on gross profit, we continually review our merchandise mix and strive to adjust it when appropriate. Maintaining an appropriate sales mix is an integral part of achieving our gross profit and sales goals.

Gross Profit. The gross profit rate increased by 201 basis points in 2007 as compared with 2006 due to a number of factors, including: an increase in purchase markups, resulting primarily from a change in mix of items and higher vendor rebates; lower markdowns, including markdowns from retail and below cost markdowns (as discussed below, markdowns in 2006 included significant markdowns and below cost adjustments relating to the initial launch of Project Alpha); and improved leverage on distribution and transportation costs driven by logistics efficiencies. Offsetting the factors listed above was an increase in our shrink rate in 2007 as compared to 2006.

The gross profit rate decline in 2006 as compared with 2005 was due primarily to a significant increase in markdown activity as a percentage of sales, including below-cost markdowns, as a result of our inventory liquidation and store closing initiatives. While we believe these initiatives had a positive impact on sales, they had a negative impact on our gross profit rate in 2006. In total, our gross profit rate declined by 289 basis points to 25.8% in 2006 compared to 28.7% in 2005. Significantly impacting our gross profit rate, as a result of the related effect on cost of goods sold, were total markdowns of $279.1 million at cost taken during 2006, compared with total markdowns of $106.5 million at cost taken in 2005. The 2006 markdowns reflect $179.9 million at cost taken during the fourth quarter of 2006 compared to $39.0 million markdowns at cost taken during the fourth quarter of 2005. Other factors included, but were not limited to: a decrease in the markups on purchases, primarily attributable to purchases of highly consumable products (including nationally branded products, which generally have lower average markups); and an increase in our shrink rate.

Selling, General and Administrative ("SG&A") Expense. SG&A expense increased $165.5 million, or 7.8%, in 2007 from the prior year, and increased as a percentage of sales to 24.1% in 2007 from 23.1% in 2006. SG&A in 2007 includes: $23.4 million related to amortization of leasehold intangibles capitalized in connection with the revaluation of assets at the date of the Merger; $27.2 million of accrued administrative employee incentive compensation expense resulting from meeting certain financial targets (compared to $9.6 million of discretionary bonuses in 2006); approximately $54 million of expenses relating to the closing of stores and the elimination of our packaway inventory strategy (compared to approximately $33 million in 2006) and an accrued loss of approximately $12.0 million relating to the probable restructuring of certain distribution center leases. In addition, SG&A in 2007 includes approximately $4.8 million of KKR-related consulting and monitoring fees. SG&A expense in 2006 was partially offset by insurance proceeds of $13.0 million received during the year related to losses incurred due to Hurricane Katrina.

The increase in SG&A expense as a percentage of sales in 2006 as compared with 2005 was due to a number of factors, including increases in the following expense categories: impairment charges on leasehold improvements and store fixtures totaling $9.4 million, including $8.0 million related to the planned closings of approximately 400 underperforming stores, 128 of which closed in 2006 and the remainder of which closed in 2007, lease contract terminations totaling $5.7 million related to these stores; higher store occupancy costs (increased 12.1%) due to higher average monthly rentals associated with our leased store locations; higher debit and credit card fees (increased 40.6%) due to the increased customer usage of debit cards and the acceptance of VISA credit and check cards at all locations; higher administrative labor costs (increased 29.9%) primarily related to additions to our executive team, particularly in merchandising and real estate, and the expensing of stock options; higher advertising costs (increased 198.3%) related primarily to the distribution of several advertising circulars in the year and to promotional activities related to the inventory clearance and store closing activities discussed above; and higher incentive compensation primarily related to the $9.6 million discretionary bonus authorized by the Board of Directors for the 2006 fiscal year. These increases were partially offset by insurance proceeds of $13.0 million received during the period related to losses incurred due to Hurricane Katrina, and depreciation and amortization expenses that remained relatively constant in fiscal 2006 as compared to fiscal 2005.

Transaction and Related Costs. The $102.6 million of expenses recorded in 2007 reflect $63.2 million of expenses related to the Merger, such as investment banking and legal fees as well as $39.4 million of compensation expense related to stock options, restricted stock and restricted stock units which were fully vested immediately prior to the Merger.

Interest Income. Interest income in 2007 consists primarily of interest on short-term investments. The increase in 2007 from 2006 resulted from higher levels of cash and short term investments on hand, primarily in the first half of the year. The decrease in 2006 compared to 2005 was due primarily to the acquisition of the entity which held legal title to the South Boston distribution center in June 2006 and the related elimination of the note receivable which represented debt issued by this entity from which we formerly leased the South Boston distribution center.

Interest Expense. Interest expense increased by $228.3 million in 2007 as compared to 2006 due to interest on long-term obligations incurred to finance the Merger. See further discussion under “Liquidity and Capital Resources” below. We had outstanding variable-rate debt of $787.0 million, after taking into consideration the impact of interest rate swaps, as of February 1, 2008. The remainder of our outstanding indebtedness at February 1, 2008 was fixed rate debt.

The increase in interest expense in 2006 was primarily attributable to increased interest expense of $6.5 million under a revolving credit agreement primarily due to increased borrowings, an increase in tax-related interest of $4.1 million, offset by a reduction in interest expense associated with the elimination of a financing obligation on the South Boston distribution center.

Loss on Interest Rate Swaps. During 2007, we recorded an unrealized loss of $4.1 million related to the change in the fair value of interest swaps prior to the designation of such swaps as cash flow hedges in October 2007. This loss is offset by earnings of $1.7 million under the contractual provisions of the swap agreements.

Loss on Debt Retirements, Net. During 2007, we recorded $6.2 million of expenses related to consent fees and other costs associated with a tender offer for certain notes payable maturing in June 2010 (“2010 Notes”). Approximately 99% of the 2010 Notes were retired as a result of the tender offer. The costs related to the tender of the 2010 Notes were partially offset by a $4.9 million gain resulting from the repurchase of $25.0 million of our 11.875%/12.625% Senior Subordinated Notes, due July 15, 2017.

Income Taxes. The effective income tax rates for the Successor period ended February 1, 2008, and the Predecessor periods ended July 6, 2007, 2006 and 2005 were a benefit of 26.9% and expense of 300.2%, 37.4% and 35.7%, respectively.

The income tax rate for the Successor period ended February 1, 2008 is a benefit of 26.9%. This benefit is less than the expected U.S. statutory rate of 35% due to the incurrence of state income taxes in several of the group's subsidiaries that file their state income tax returns on a separate entity basis and the election to include, effective February 3, 2007, income tax related interest and penalties in the amount reported as income tax expense.

The income tax rate for the Predecessor period ended July 6, 2007 is an expense of 300.2%. This expense is higher than the expected U.S. statutory rate of 35% due principally to the non-deductibility of certain acquisition related expenses.

The 2006 income tax rate was higher than the 2005 rate by 1.7%. Factors contributing to this increase include additional expense related to the adoption of a new tax system in the State of Texas; a reduction in the contingent income tax reserve due to the resolution of contingent liabilities that is less than the decrease that occurred in 2005; an increase in the deferred tax valuation allowance; and an increase related to a non-recurring benefit recognized in 2005 related to an internal restructuring. Offsetting these rate increases was a reduction in the income tax rate related to federal income tax credits. Due to the reduction in our 2006 income before tax, a small increase in the amount of federal income tax credits earned yielded a much larger percentage reduction in the income tax rate for 2006 versus 2005.

Effects of Inflation

We believe that inflation and/or deflation had a minimal impact on our overall operations during 2007, 2006 and 2005.

Liquidity and Capital Resources

Current Financial Condition / Recent Developments. During the past three years, we have generated an aggregate of approximately $1.4 billion in cash flows from operating activities. During that period, we expanded the number of stores we operate by approximately 12% (874 stores) and incurred approximately $685 million in capital expenditures. As noted above, we made certain strategic decisions which slowed our growth in 2007.

At February 1, 2008, we had total outstanding debt (including the current portion of long-term obligations) of $4.282 billion. We also had an additional $769.2 million available for borrowing under our new senior secured asset-based revolving credit facility at that date. Our liquidity needs are significant, primarily due to our debt service and other obligations.

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

New Credit Facilities

Overview. On July 6, 2007, in connection with the Merger, we entered into two senior secured credit agreements, each with Goldman Sachs Credit Partners L.P., Citicorp Global Markets Inc., Lehman Brothers Inc. and Wachovia Capital Markets, LLC, each as joint lead arranger and joint bookrunner. The CIT Group/Business Credit, Inc. is administrative agent under the senior secured credit agreement for the asset-based revolving credit facility and Citicorp North America, Inc. is administrative agent under the senior secured credit agreement for the term loan facility.

The New Credit Facilities provide financing of $3.425 billion, consisting of:

· $2.3 billion in a senior secured term loan facility; and

· a senior secured asset-based revolving credit facility of up to $1.125 billion (of which up to $350.0 million is available for letters of credit), subject to borrowing base availability.

The term loan credit facility consists of two tranches, one of which is a “first-loss” tranche, which, in certain circumstances, is subordinated in right of payment to the other tranche of the term loan credit facility.

We are the borrower under the term loan credit facility, the primary borrower under the asset-based credit facility and, in addition, certain subsidiaries of ours are designated as borrowers under this facility. The asset-based credit facility includes borrowing capacity available for letters of credit and for short-term borrowings referred to as swingline loans.

The New Credit Facilities provide that we have the right at any time to request up to $325.0 million of incremental commitments under one or more incremental term loan facilities and/or asset-based revolving credit facilities. The lenders under these facilities are not under any obligation to provide any such incremental commitments and any such addition of or increase in commitments will be subject to our not exceeding certain senior secured leverage ratios and certain other customary conditions precedent. Our ability to obtain extensions of credit under these incremental commitments will also be subject to the same conditions as extensions of credit under the New Credit Facilities.

The amount from time to time available under the senior secured asset-based credit facility (including in respect of letters of credit) shall not exceed the sum of the tranche A borrowing base and the tranche A-1 borrowing base. The tranche A borrowing base equals the sum of (i) 85% of the net orderly liquidation value of all our eligible inventory and that of each guarantor thereunder and (ii) 90% of all our accounts receivable and credit/debit card receivables and that of each guarantor thereunder, in each case, subject to a reserve equal to the principal amount of the 2010 Notes that remain outstanding at any time and other customary reserves and eligibility criteria. An additional 10% to 12% of the net orderly liquidation value of all our eligible inventory and that of each guarantor thereunder is made available to us in the form of a “last out” tranche in respect of which we may borrow up to a maximum amount of $125.0

million. Borrowings under the asset-based credit facility will be incurred first under the last out tranche, and no borrowings will be permitted under any other tranche until the last out tranche is fully utilized. Repayments of the senior secured asset-based revolving credit facility will be applied to the last out tranche only after all other tranches have been fully paid down.

Interest Rate and Fees. Borrowings under the New Credit Facilities bear interest at a rate equal to an applicable margin plus, at our option, either (a) LIBOR or (b) a base rate (which is usually equal to the prime rate). The applicable margin for borrowings is (i) under the term loan facility, 2.75% with respect to LIBOR borrowings and 1.75% with respect to base-rate borrowings and (ii) as of February 1, 2008 under the asset-based revolving credit facility (except in the last out tranche described above), 1.50% with respect to LIBOR borrowings and 0.50% with respect to base-rate borrowings and for any last out borrowings, 2.25% with respect to LIBOR borrowings and 1.25% with respect to base-rate borrowings. The applicable margins for borrowings under the asset-based revolving credit facility (except in the case of last out borrowings) are subject to adjustment each quarter based on average daily excess availability under the asset-based revolving credit facility.

In addition to paying interest on outstanding principal under the New Credit Facilities, we are required to pay a commitment fee to the lenders under the asset-based revolving credit facility in respect of the unutilized commitments thereunder. At February 1, 2008 the commitment fee rate was 0.375% per annum. The commitment fee rate will be reduced (except with regard to the last out tranche) to 0.25% per annum at any time that the unutilized commitments under the asset-based credit facility are equal to or less than 50% of the aggregate commitments under the asset-based revolving credit facility. We must also pay customary letter of credit fees.

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

- 50% of our annual excess cash flow (as defined in the credit agreement) commencing with the fiscal year ending on or about January 31, 2008 (which percentage will be reduced to 25% and 0% if we achieve and maintain a total net leverage ratio of 6.0 to 1.0 and 5.0 to 1.0, respectively);

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

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

The mandatory prepayments discussed above will be applied to the term loan facility as directed by the senior secured credit agreement.

In addition, the senior secured credit agreement for the asset-based revolving credit facility requires us to prepay the asset-based revolving credit facility, subject to certain exceptions, with:

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

· to the extent such extensions of credit exceed the then current borrowing base (as defined in the senior secured credit agreement for the asset-based revolving credit facility).

We may be obligated to pay a prepayment premium on the amount repaid under the term loan facility if the term loans are voluntarily repaid in whole or in part before July 6, 2009. We may voluntarily repay outstanding loans under the asset-based revolving credit facility at any time without premium or penalty, other than customary “breakage” costs with respect to LIBOR loans.

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

Letters of Credit. $350.0 million of our asset-based revolving credit facility is available for letters of credit.

Amortization. Beginning September 30, 2009, we are required to repay installments on the loans under the term loan credit facility in equal quarterly principal amounts in an aggregate amount per annum equal to 1% of the total funded principal amount at July 6, 2007, with the balance payable on July 6, 2014. There is no amortization under the asset-based revolving credit facility. The entire principal amounts (if any) outstanding under the asset-based revolving credit facility are due and payable in full at maturity, on July 6, 2013, on which day the commitments thereunder will terminate.

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

All obligations and related guarantees under the term loan credit facility are secured by:

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

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

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

All obligations and related guarantees under the asset-based credit facility are secured by the Revolving Facility Collateral, subject to certain exceptions.

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

· incur additional indebtedness;

· sell assets;

· pay dividends and distributions or repurchase our capital stock;

· make investments or acquisitions;

· repay or repurchase subordinated indebtedness (including the senior subordinated notes discussed below) and the senior notes discussed below;

· amend material agreements governing our subordinated indebtedness (including the senior subordinated notes discussed below) or our senior notes discussed below; and

· change our lines of business.

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

At February 1, 2008, we had $102.5 million of borrowings, $28.8 million of commercial letters of credit, and $69.2 million of standby letters of credit outstanding under our asset-based revolving credit facility.

Senior Notes due 2015 and Senior Subordinated Toggle Notes due 2017

On July 6, 2007, we issued $1,175.0 million aggregate principal amount of 10.625% senior notes due 2015 (the “senior notes”) which mature on July 15, 2015 pursuant to an indenture, dated as of July 6, 2007 (the “senior indenture”), and $725 million aggregate principal amount of 11.875%/12.625% senior subordinated toggle notes due 2017 (the “senior subordinated notes”), which mature on July 15, 2017, pursuant to an indenture, dated as of July 6, 2007 (the “senior subordinated indenture”). The senior notes and the senior subordinated notes are collectively referred to herein as the “notes.” The senior indenture and the senior subordinated indenture are collectively referred to herein as the “indentures.”

Interest on the notes is payable on January 15 and July 15 of each year, commencing January 15, 2008. Interest on the senior notes will be payable in cash. Cash interest on the senior subordinated notes will accrue at a rate of 11.875% per annum, and PIK interest (as that term is defined below) will accrue at a rate of 12.625% per annum. The initial interest payment on the senior subordinated notes will be payable in cash. For any interest period thereafter through July 15, 2011, we may elect to pay interest on the senior subordinated notes (i) in cash, (ii) by increasing the principal amount of the senior subordinated notes or issuing new senior subordinated notes (“PIK interest”) or (iii) by paying interest on half of the principal amount of the senior subordinated notes in cash interest and half in PIK interest. After July 15, 2011, all interest on the senior subordinated notes will be payable in cash.

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

We may redeem some or all of the notes at any time at redemption prices described or set forth in the indentures. We repurchased $25.0 million of the 11.875%/12.625% senior subordinated toggle notes in the fourth quarter of 2007.

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

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

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

· pay dividends on or make certain distributions and other restricted payments;

· create certain liens or encumbrances;

· sell assets;

· enter into transactions with affiliates;

· make payments to us;

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

- designate our subsidiaries as unrestricted subsidiaries.

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

Registration Rights Agreement. On July 6, 2007, we entered into a registration rights agreement with respect to the notes. In the registration rights agreement, we agreed to use commercially reasonable efforts to register with the SEC new senior notes having substantially identical terms as the senior notes and new senior subordinated notes having substantially identical terms as the senior subordinated notes. We filed this registration statement with the SEC, and it was declared effective, in the fourth quarter of fiscal 2007. We subsequently commenced the offer to exchange the new senior notes and the new senior subordinated notes for each of the outstanding senior notes and the outstanding senior subordinated notes, respectively. The exchange offer expired on March 17, 2008. All of the outstanding senior notes and senior subordinated notes were tendered in the exchange offer.

Adjusted EBITDA

Under the New Credit Facilities and the indentures, certain limitations and restrictions could occur if we are not able to satisfy and remain in compliance with specified financial ratios. Management believes the most significant of such ratios is the senior secured incurrence test under the New Credit Facilities. This test measures the ratio of the senior secured debt to Adjusted EBITDA. This ratio would need to be no greater than 4.25 to 1 to avoid such limitations and restrictions. As of February 1, 2008, this ratio was 3.4 to 1. Senior secured debt is defined as our total debt secured by liens or similar encumbrances less cash and cash equivalents. EBITDA is defined as income (loss) from continuing operations before cumulative effect of change in accounting principle plus interest and other financing costs, net, provision for income taxes, and depreciation and amortization. Adjusted EBITDA is defined as EBITDA, further adjusted to give effect to adjustments required in calculating this covenant ratio under our New Credit Facilities. EBITDA and Adjusted EBITDA are not presentations made in accordance with GAAP, are not measures of financial performance or condition, liquidity or profitability, and should not be considered as an alternative to (1) net income, operating income or any other performance measures determined in accordance with GAAP or (2) operating cash flows determined in accordance with GAAP. Additionally, EBITDA and Adjusted EBITDA are not intended to be measures of free cash flow for management’s discretionary use, as they do not consider certain cash requirements such as interest payments, tax payments and debt service requirements and replacements of fixed assets.

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

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

(In millions)	Year Ended February 1, 2008
Net income (loss)	$ (12.8)
Add (subtract):	
Interest income	(8.8)
Interest expense	263.2
Depreciation and amortization	226.4
Income taxes	10.2
EBITDA	478.2
Adjustments:	
Transaction and related costs	102.6
Loss on debt retirements, net	1.2
Loss on interest rate swaps	2.4
Contingent loss on distribution center leases	12.0
Impact of markdowns related to inventory clearance activities, including LCM adjustments, net of purchase accounting adjustments	5.7
SG&A related to store closing and inventory clearance activities	54.0
Operating losses (cash) of stores to be closed	10.5
Monitoring and consulting fees to	4.8

affiliates		
Stock option and restricted stock unit expense		6.5
Indirect merger-related costs		4.6
Other		1.0
Total Adjustments		205.3
Adjusted EBITDA	$	683.5

Other Considerations

Our inventory balance represented approximately 44% of our total assets exclusive of goodwill and other intangible assets as of February 1, 2008. Our proficiency in managing our inventory balances can have a significant impact on our cash flows from operations during a given fiscal year. We have made more efficient inventory management a strategic priority, as more fully discussed in the "Executive Overview" above.

During 2006 and 2005, the Predecessor's Board of Directors authorized the repurchase of up to $500 million and 10 million shares, respectively, of the Predecessor's outstanding common stock. These authorizations allowed purchases in the open market or in privately negotiated transactions from time to time, subject to market conditions. During 2006, we purchased approximately 4.5 million shares pursuant to the 2005 authorization at a total cost of $79.9 million. During 2005, we purchased approximately 15.0 million shares pursuant to the 2005 and a prior authorization at a total cost of $297.6 million.

We may seek, from time to time, to retire the notes (as defined above) through cash purchases on the open market, in privately negotiated transactions or otherwise. Such repurchases, if any, will depend on prevailing market conditions, our liquidity requirements, contractual restrictions and other factors. The amounts involved may be material.

The following table summarizes our significant contractual obligations and commercial commitments as of February 1, 2008 (in thousands):

	Payments Due by Period				
Contractual obligations	Total	< 1 yr	1-3 yrs	3-5 yrs	> 5 yrs
Long-term debt obligations	$4,293,718	$ -	$ 36,223	$ 46,000	$4,211,495
Capital lease obligations	10,268	3,246	1,957	526	4,539
Interest (a)	2,817,237	382,587	762,872	756,070	915,708
Self-insurance liabilities (b)	203,600	68,613	89,815	26,612	18,560
Operating leases (c)	1,614,215	335,457	524,363	357,418	396,977
Monitoring agreement (d)	24,903	5,250	10,763	8,890	-
Subtotal	$8,963,941	$ 795,153	$1,425,993	$1,195,516	$5,547,279

	Commitments Expiring by Period				
Commercial commitments (e)	Total	< 1 yr	1-3 yrs	3-5 yrs	> 5 yrs
Letters of credit	$ 28,778	$ 28,778	$ -	$ -	$ -
Purchase obligations (f)	385,366	384,892	474	-	-
Subtotal	$ 414,144	$ 413,670	$ 474	$ -	$ -
Total contractual obligations and commercial commitments	$9,378,085	$1,208,823	$1,426,467	$1,195,516	$5,547,279

(a) Represents obligations for interest payments on long-term debt and capital lease obligations, and includes projected interest on variable rate long-term debt, based upon 2007 year end rates.
(b) We retain a significant portion of the risk for our workers' compensation, employee health insurance, general liability, property loss and automobile insurance. As these obligations do not have scheduled maturities, these amounts represent undiscounted estimates based upon actuarial assumptions. Reserves for workers' compensation and general liability which existed as of the Merger date were discounted in order to arrive at estimated fair value. All other amounts are reflected on an undiscounted basis in our consolidated balance sheets.
(c) Operating lease obligations are inclusive of amounts included in deferred rent and closed store obligations in our consolidated balance sheets.
(d) We entered into a monitoring agreement, dated July 6, 2007, with affiliates of certain of our Investors pursuant to which those entities will provide management and advisory services. Such agreement has no contractual term and for purposes of this schedule is presumed to be outstanding for a period of five years.
(e) Commercial commitments include information technology license and support agreements, supplies, fixtures, letters of credit for import merchandise, and other inventory purchase obligations.
(f) Purchase obligations include legally binding agreements for software licenses and support, supplies, fixtures, and merchandise purchases excluding such purchases subject to letters of credit.

In 2007 and 2006, our South Carolina-based wholly owned captive insurance subsidiary, Ashley River Insurance Company ("ARIC"), had cash and cash equivalents and investments balances held pursuant to South Carolina regulatory requirements to maintain a specified percentage of ARIC's liability and equity balances (primarily insurance liabilities) in the form of certain specified types of assets and, as such, these investments are not available for general corporate purposes. At February 1, 2008, these cash and cash equivalents balances and investments balances were $11.9 million and $51.5 million, respectively.

During 2005, we incurred significant losses caused by Hurricane Katrina, primarily inventory and fixed assets, in the form of store fixtures and leasehold improvements. We reached final settlement of our related insurance claim in 2006 and received proceeds totaling $21.0 million due to these losses, including $13.0 million in 2006 and $8.0 million in 2005, and have utilized a portion of these proceeds to replace lost assets. Insurance proceeds related to fixed assets are included in cash flows from investing activities and proceeds related to inventory losses and business interruption are included in cash flows from operating activities.

Legal actions, claims and tax contingencies. As described in Note 7 to the Consolidated Financial Statements, we are involved in a number of legal actions and claims, some of which could potentially result in material cash payments. Adverse developments in those actions could materially and adversely affect our liquidity. As discussed in Note 5 we also have certain income tax-related contingencies as more fully described below under "Critical Accounting Policies and Estimates." Future negative developments could have a material adverse effect on our liquidity.

Considerations regarding distribution center leases. The Merger and certain of the related financing transactions may be interpreted as giving rise to certain trigger events (which may include events of default) under our three distribution center leases. In that event, our additional cost of acquiring the underlying land and building assets could approximate $112 million. At this time, we do not believe such issues would result in the purchase of these distribution centers; however, the payments associated with such an outcome would have a negative impact on our liquidity. To minimize the uncertainty associated with such possible interpretations, we are negotiating the restructuring of these leases and the related underlying debt. We have concluded that a probable loss exists in connection with the restructurings and have recorded associated SG&A expenses in the Successor financial statements for the period ended February 1, 2008 totaling $12.0 million. The ultimate resolution of these negotiations may result in changes in the amounts of such losses, which changes may be material.

Credit ratings. On June 12, 2007 Standard & Poor's revised our long-term debt rating to B, and left our long-term debt ratings on negative watch. Moody's revised our long-term debt rating to B3 with a stable outlook. These current ratings are considered non-investment grade. Our current credit ratings, as well as future rating agency actions, could (1) negatively impact our ability to obtain financings to finance our operations on satisfactory terms; (2) have the effect of increasing our financing costs; and (3) have the effect of increasing our insurance premiums and collateral requirements necessary for our self-insured programs.

Cash flows

The discussion of the cash flows from operating, investing and financing activities included below for 2007 is generally based on the combination of the Predecessor and Successor for the 52-week period ended February 1, 2008, which we believe provides a more meaningful understanding of our liquidity and capital resources for the time period presented.

Cash flows from operating activities. Cash flows from operating activities for 2007 compared to 2006 increased by $36.2 million, notwithstanding a decline in net income (loss) of $150.8 million, as described in detail under “Results of Operations” above, and which is partially attributable to $102.6 million of Transaction and related costs in 2007. Other significant components of the change in cash flows from operating activities in 2007 as compared to 2006 were changes in inventory balances, which decreased by approximately 10% during 2007 compared to a decrease of approximately 3% during 2006. Inventory levels in the seasonal category declined by $84.5 million, or 24%, in 2007 compared to a $6.7 million, or 2%, increase in 2006. The highly consumable category declined by $42.4 million, or 6%, in 2007 compared to a $63.2 million, or 10%, increase in 2006. The home products category increased by $3.5 million, or 2%, in 2007 as compared to a $52.5 million, or 25%, decline in 2006. The basic clothing category decreased by $20.3 million, or 9%, in 2007 as compared to a $59.5 million, or 21%, decrease in 2006. In addition to inventory changes the decline in net income was a principal factor in the reduction in income taxes paid in 2007 as compared to 2006. Also offsetting the decline in net income were changes in accrued expenses in 2007 as compared to 2006, which increased primarily due to income tax related reserves, accrued interest, incentive compensation accrual, the accrued loss in connection with the ongoing negotiations to restructure our distribution center leases, and accruals for lease liabilities on closed stores.

Cash flows from operating activities for 2006 compared to 2005 declined by $150.1 million. The most significant component of the decline in cash flows from operating activities in 2006 as compared to 2005 was the reduction in net income, as described in detail under “Results of Operations” above. Partially offsetting this decline are certain noncash charges included in net income, including below-cost markdowns on inventory balances and property and equipment impairment charges totaling $78.1 million, and a $13.8 million increase in noncash depreciation and amortization charges in 2006 as compared to 2005. In addition, the reduction in 2006 year end inventory balances reflect the effect of below-cost markdowns and our efforts to sell through excess inventories, as compared with increases in 2005 and 2004. Seasonal inventory levels increased by 2% in 2006 as compared to a 10% increase in 2005, home products inventory levels declined by 25% in 2006 as compared to a 2% increase in 2005, while basic clothing inventory levels declined by 21% in 2006 as compared to a 5% decline in 2005. Total merchandise inventories at the end of 2006 were $1.43 billion compared to $1.47 billion at the end of 2005, a 2.9% decrease overall, and a 6.4% decrease on a per store basis, reflecting both our focus on liquidating packaway merchandise and the effect of below-cost markdowns.

Cash flows from investing activities. The Merger, as discussed in more detail above, required cash payments of approximately $6.7 billion, net of cash acquired of $350 million. Significant components of property and equipment purchases in 2007 included the following approximate amounts: $60 million for improvements, upgrades, remodels and relocations of existing stores; $45 million for new stores; and $30 million for distribution and transportation-related capital expenditures. During 2007, we opened 365 new stores and remodeled or relocated 300 stores.

During 2007 we purchased a secured promissory note for $37.0 million which represents debt issued by a third-party entity from which we lease our distribution center in Ardmore, Oklahoma. Purchases and sales of short-term investments in 2007, which equaled net sales of $22.1 million, primarily reflect our investment activities in our captive insurance subsidiary, and all purchases of long-term investments are related to the captive insurance subsidiary.

Cash flows used in investing activities totaling $282.0 million in 2006 were primarily related to capital expenditures and, to a lesser degree, purchases of long-term investments. Significant components of our property and equipment purchases in 2006 included the following approximate amounts: $66 million for distribution and transportation-related capital expenditures (including approximately $30 million related to our distribution center in Marion, Indiana which opened in 2006); $66 million for new stores; $50 million for the EZstoreTM project; and $38 million for capital projects in existing stores. During 2006 we opened 537 new stores and remodeled or relocated 64 stores.

Purchases and sales of short-term investments in 2006, which equaled net sales of $1.9 million, reflect our investment activities in tax-exempt auction rate securities as well as investing activities of our captive insurance subsidiary. Purchases of long-term investments are related to the captive insurance subsidiary.

Significant components of our purchases of property and equipment in 2005 included the following approximate amounts: $102 million for distribution and transportation-related capital expenditures; $96 million for new stores; $47 million related to the EZstoreTM project; $18 million for certain fixtures in existing stores; and $15 million for various systems-related capital projects. During 2005, we opened 734 new stores and relocated or remodeled 82 stores. Distribution and transportation expenditures in 2005 included costs associated with the construction of our new distribution centers in South Carolina and Indiana.

Net sales of short-term investments in 2005 of $34.1 million primarily reflect our investment activities in tax-exempt auction rate securities. Purchases of long-term investments are related to our captive insurance subsidiary.

Capital expenditures during 2008 are projected to be approximately $200 to $220 million. We anticipate funding 2008 capital requirements with cash flows from operations and our revolving credit facility, if necessary. Significant components of the 2008 capital plan include growth initiatives as well as continued investment in our existing store base, plans for remodeling and relocating approximately 400 stores, additional investments in our supply chain, and leasehold improvements and fixtures and equipment for approximately 200 new stores. We plan to undertake these expenditures in order to improve our infrastructure and enhance our cash generated from operating activities.

Cash flows from financing activities. To finance the Merger, we issued long-term debt of approximately $4.2 billion and issued common stock in the amount of approximately $2.8 billion. We incurred costs associated with the issuance of Merger-related long-term debt of $87.4 million. As discussed above, we completed a cash tender offer for our 2010 Notes. Approximately 99% of the 2010 Notes were validly tendered resulting in repayments of long-term debt and related consent fees in the amount of $215.6 million. Borrowings, net of repayments, under our new asset-based revolving credit facility in 2007 totaled $102.5 million.

Cash flows used in financing activities during 2006 included the repurchase of approximately 4.5 million shares of our common stock at a total cost of $79.9 million, cash dividends paid of $62.5 million, or $0.20 per share, on our outstanding common stock, and $14.1 million to reduce our outstanding capital lease and financing obligations. These uses of cash were partially offset by proceeds from the exercise of stock options during 2006 of $19.9 million.

During 2005, we repurchased approximately 15.0 million shares of our common stock at a total cost of $297.6 million, paid cash dividends of $56.2 million, or $0.175 per share, on our outstanding common stock, and expended $14.3 million to reduce our outstanding capital lease and financing obligations. Also in 2005, we received proceeds of $14.5 million from the issuance of a tax increment financing in conjunction with the construction of our new distribution center in Indiana and proceeds from the exercise of stock options of $29.4 million.

The borrowings and repayments under the revolving credit agreements in 2007, 2006 and 2005 were primarily a result of activity associated with periodic cash needs.

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 (see discussion below) and recent improvements in the LIFO analysis whereby all SKUs are considered in the 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 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.

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.

Goodwill and Indefinite-Lived Intangible Assets. Under SFAS 142, “Goodwill and Other Intangible Assets”, we are required to test goodwill and intangible assets with indefinite lives for impairment annually, or more frequently if impairment indicators occur. Significant judgments required in this testing process may include projecting future cash flows, determining appropriate discount rates and other assumptions. Projections are based on management’s best estimate given recent financial performance, market trends, strategic plans and other available information. Changes in these estimates and assumptions could materially affect the determination of fair value or impairment. Future indicators of impairment could result in an asset impairment charge.

Purchase Accounting. The Merger was accounted for as a reverse acquisition in accordance with the purchase accounting provisions of SFAS 141, “Business Combinations,” under which our assets and liabilities have been accounted for at their estimated fair values as of the date of the Merger. The aggregate purchase price was allocated to the tangible and intangible assets acquired and liabilities assumed, based upon an assessment of their relative fair values as of the date of the Merger. These estimates of fair values, the allocation of the purchase price and other factors related to the accounting for the Merger are subject to significant judgments and the use of estimates.

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. Certain store and warehouse fixtures, when fully depreciated, are removed from the cost and related accumulated depreciation and amortization accounts. The valuation and classification of these assets and the assignment of 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 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 are difficult to predict. If a long-lived asset is found to be impaired, the amount recognized for impairment is equal to the difference between the carrying value and the asset’s 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. At the date of the Merger this liability was discounted in accordance with purchase accounting standards. Subsequent to the Merger, 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 using actuarial methodologies based on 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 we adopted on 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 on a quarterly basis or as new and significant information becomes available to determine whether a liability should be established or if any existing liability should be adjusted. The actual cost of resolving a claim or proceeding ultimately may be substantially different than the amount of the recorded liability. In addition, because it is not permissible under 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 7 to the 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 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 (excluding those associated with a business combination) where a lease obligation still exists, we record the estimated future liability associated with the rental obligation on the date the store is closed in accordance with 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 (which is based on a peer group of publicly traded companies), 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.

Adoption of 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. After the Merger and the related application of purchase accounting, no portion of the reserve for uncertain tax positions that existed as of the date of adoption would impact our effective tax rate but would, if subsequently recognized, reduce the amount of goodwill recorded in relation to the Merger.

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

Accounting Pronouncements

In March 2008, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 161, “Disclosures about Derivative Instruments and Hedging Activities”, an amendment of FASB Statement No. 133. SFAS 161 applies to all derivative instruments and nonderivative instruments that are designated and qualify as hedging instruments pursuant to paragraphs 37 and 42 of SFAS 133 and related hedged items accounted for under SFAS 133. SFAS 161 requires entities to provide greater transparency through additional disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations, and how derivative instruments and related hedged items affect an entity’s financial position, results of operations, and cash flows. SFAS 161 is effective as of the beginning of an entity’s first fiscal year that begins after November 15, 2008. We currently plan to adopt SFAS 161 during our 2009 fiscal year. No determination has yet been made regarding the potential impact of this standard on our financial statements.

In December 2007, the FASB issued SFAS No. 141(R), “Business Combinations”. The new standard establishes the requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest (formerly minority interest) in an acquiree; provides updated requirements for recognition and measurement of goodwill acquired in the business combination or a gain from a bargain purchase; and provides updated disclosure requirements to enable users of financial statements to evaluate the nature and financial effects of the business combination. This Statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Early adoption is not allowed. This standard is not expected to impact our financial statements unless a qualifying transaction is consummated subsequent to the effective date.

In February 2007 the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115" (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. It provides entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. We currently plan to adopt SFAS 159 during our 2008 fiscal year. We are in the process of evaluating the potential impact of this standard on our consolidated financial statements.

In September 2006, the FASB issued SFAS 157, "Fair Value Measurements." SFAS 157 provides guidance for using fair value to measure assets and liabilities. The standard also requires expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. The standard applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. For non-financial assets and liabilities, the effective date has been delayed to fiscal years beginning after November 15, 2008. We currently expect to adopt SFAS 157 during our 2008 and 2009 fiscal years. We are in the process of evaluating the potential impact of this standard on our consolidated financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Financial Risk Management

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

Interest Rate Risk

We manage our interest rate risk through the strategic use of fixed and variable interest rate debt and, from time to time, derivative financial instruments. Our principal interest rate exposure relates to outstanding amounts under our New Credit Facilities. Our New Credit Facilities provide for variable rate borrowings of up to $3,425.0 million including availability of $1,125.0 million under our senior secured asset-based revolving credit facility, subject to the borrowing base. In order to mitigate a portion of the variable rate interest exposure under the New Credit Facilities, we entered into interest rate swaps with affiliates of Goldman, Sachs & Co., Lehman Brothers Inc. and Wachovia Capital Markets, LLC. Pursuant to the swaps, which became effective on July 31, 2007, we swapped three month LIBOR rates for fixed interest rates which will result in the payment of a fixed rate of 7.68% on a notional amount of $2,000.0 million which will amortize on a quarterly basis until maturity at July 31, 2012. At February 1, 2008, the notional amount was $1,630.0 million.

A change in interest rates on variable rate debt impacts our pre-tax earnings and cash flows; whereas a change in interest rates on fixed rate debt impacts the economic fair value of debt but not our pre-tax earnings and cash flows. Our derivatives qualify for hedge accounting as cash flow hedges. Therefore, changes in market fluctuations related to the effective portion of these cash flow hedges do not impact our pre-tax earnings until the accrued interest is recognized on the derivatives and the associated hedged debt. Based on our outstanding debt as of February 1, 2008 and assuming that our mix of debt instruments, derivative instruments and other variables remain the same, the annualized effect of a one percentage point change in variable interest rates would have a pretax impact on our earnings and cash flows of approximately $7.9 million.

The interest rate swaps are accounted for in accordance with SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities", as amended and interpreted (collectively, "SFAS 133"). SFAS 133 establishes accounting and reporting standards for derivative instruments and hedging activities. SFAS 133 requires that all derivatives be recognized as either assets or liabilities at fair value. Beginning October 12, 2007, we are accounting for the swaps described above as cash flow hedges and record the effective portion of changes in fair value of the swaps within accumulated other comprehensive income.

Subsequent to the 2007 fiscal year end, we entered into a $350.0 million step-down interest rate swap which became effective February 28, 2008 in order to mitigate an additional portion of the variable rate interest exposure under the New Credit Facilities. We entered into the swap with Wachovia Capital Markets and we swapped one month LIBOR rates for fixed interest rates, which will result in the payment of a fixed rate of 5.58% on a notional amount of $350.0 million for the first year and $150.0 million for the second year.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of
Dollar General Corporation

We have audited the accompanying consolidated balance sheets of Dollar General Corporation and subsidiaries as of February 1, 2008 (Successor) and February 2, 2007 (Predecessor), and the related consolidated statements of operations, shareholders' equity, and cash flows for the periods from March 6, 2007 to February 1, 2008 (Successor), February 3, 2007 to July 6, 2007 (Predecessor) and for the years ended February 2, 2007 and February 3, 2006 (Predecessor). These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Dollar General Corporation and subsidiaries at February 1, 2008 (Successor) and February 2, 2007 (Predecessor), and the consolidated results of their operations and their cash flows for the periods from March 6, 2007 to February 1, 2008 (Successor), February 3, 2007 to July 6, 2007 (Predecessor) and for the years ended February 2, 2007 and February 3, 2006 (Predecessor), in conformity with U.S. generally accepted accounting principles.

As discussed in Notes 1 and 9 to the consolidated financial statements, effective February 4, 2006, the Company changed its method of accounting for stock-based compensation in connection with the adoption of Statement of Financial Accounting Standards No. 123(R), “Share-Based Payment”.

As discussed in Notes 1 and 5 to the consolidated financial statements, effective February 3, 2007, the Company changed its method of accounting for uncertain tax positions in connection with the adoption of FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes”.

/s/ Ernst & Young LLP

Nashville, Tennessee
March 25, 2008

CONSOLIDATED BALANCE SHEETS
(In thousands except per share amounts)

	Successor February 1, 2008	Predecessor February 2, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 100,209	$ 189,288
Short-term investments	19,611	29,950
Merchandise inventories	1,288,661	1,432,336
Income taxes receivable	32,501	9,833
Deferred income taxes	17,297	24,321
Prepaid expenses and other current assets	59,465	57,020
Total current assets	1,517,744	1,742,748
Net property and equipment	1,274,245	1,236,874
Goodwill	4,344,930	2,337
Intangible assets, net	1,370,557	86
Other assets, net	148,955	58,469
Total assets	$ 8,656,431	$ 3,040,514
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term obligations	$ 3,246	$ 8,080
Accounts payable	551,040	555,274
Accrued expenses and other	300,956	253,558
Income taxes payable	2,999	15,959
Total current liabilities	858,241	832,871
Long-term obligations	4,278,756	261,958
Deferred income taxes	486,725	41,597
Other liabilities	319,714	158,341
Commitments and contingencies		
Redeemable common stock	9,122	-
Shareholders' equity:		
Preferred stock, Shares authorized: 1,000,000	-	
Series B junior participating preferred stock, stated value $0.50 per share; Shares authorized: 10,000; Issued: None		-
Common stock; $0.50 par value, 1,000,000 shares authorized, 555,482 shares issued and outstanding at February 1, 2008 and 500,000 shares authorized, 312,436 shares issued and outstanding at February 2, 2007, respectively.	277,741	156,218
Additional paid-in capital	2,480,062	486,145
Retained earnings (accumulated deficit)	(4,818)	1,103,951
Accumulated other comprehensive loss	(49,112)	(987)
Other shareholders' equity	-	420
Total shareholders' equity	2,703,873	1,745,747
Total liabilities and shareholders' equity	$ 8,656,431	$ 3,040,514

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

CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands)

	Successor	Predecessor	For the years ended	
	July 7, 2007 through February 1, 2008 (a)	February 3, 2007 through July 6, 2007	February 2, 2007	February 3, 2006
	(30 weeks)	(22 weeks)	(52 weeks)	(53 weeks)
Net sales	$ 5,571,493	$ 3,923,753	$ 9,169,822	$ 8,582,237
Cost of goods sold	3,999,599	2,852,178	6,801,617	6,117,413
Gross profit	1,571,894	1,071,575	2,368,205	2,464,824
Selling, general and administrative	1,324,508	960,930	2,119,929	1,902,957
Transaction and related costs	1,242	101,397	-	-
Operating profit	246,144	9,248	248,276	561,867
Interest income	(3,799)	(5,046)	(7,002)	(9,001)
Interest expense	252,897	10,299	34,915	26,226
Loss on interest rate swaps	2,390	-	-	-
Loss on debt retirement, net	1,249	-	-	-
Income (loss) before income taxes	(6,593)	3,995	220,363	544,642
Income tax expense (benefit)	(1,775)	11,993	82,420	194,487
Net income (loss)	$ (4,818)	$ (7,998)	$ 137,943	$ 350,155

(a) Includes the results of operations of Buck Acquisition Corp. for the period prior to its merger with and into Dollar General Corporation from March 6, 2007 (its formation) through July 6, 2007 (reflecting the change in fair value of interest rate swaps), and the post-merger results of Dollar General Corporation for the period from July 7, 2007 through February 1, 2008. See Notes 1 and 2.

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

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(In thousands except per share amounts)

	Common Stock Shares	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Other Shareholders' Equity	Total
Predecessor Balances, January 28, 2005	328,172	$ 164,086	$ 421,600	$ 1,102,457	$ (973)	$ (2,705)	$ 1,684,465
Comprehensive income:							
Net income	-	-	-	350,155	-	-	350,155
Reclassification of net loss on derivatives	-	-	-	-	179	-	179
Comprehensive income							350,334
Cash dividends, $0.175 per common share	-	-	-	(56,183)	-	-	(56,183)
Issuance of common stock under stock incentive plans	2,249	1,125	28,280	-	-	-	29,405
Tax benefit from stock option exercises	-	-	6,457	-	-	-	6,457
Repurchases of common stock	(14,977)	(7,489)	-	(290,113)	-	-	(297,602)
Sales of common stock by employee deferred compensation trust, net (42 shares)	-	-	95	-	-	788	883
Issuance of restricted stock and restricted stock units, net	249	125	5,151	-	-	(5,276)	-
Amortization of unearned compensation on restricted stock and restricted stock units	-	-	-	-	-	2,394	2,394
Acceleration of vesting of stock options (see Note	-	-	938	-	-	-	938

9)							
Other equity transactions	(14)	(7)	(138)	(151)	-	-	(296)
Predecessor Balances, February 3, 2006	315,679	$ 157,840	$ 462,383	$ 1,106,165	$ (794)	$ (4,799)	$ 1,720,795
Comprehensive income:							
Net income	-	-	-	137,943	-	-	137,943
Reclassification of net loss on derivatives	-	-	-	-	188	-	188
Comprehensive income							138,131
Cash dividends, $0.20 per common share	-	-	-	(62,472)	-	-	(62,472)
Issuance of common stock under stock incentive plans	1,573	786	19,108	-	-	-	19,894
Tax benefit from share-based payments	-	-	2,513	-	-	-	2,513
Repurchases of common stock	(4,483)	(2,242)	-	(77,705)	-	-	(79,947)
Purchases of common stock by employee deferred compensation trust, net (3 shares)	-	-	(2)	-	-	40	38
Reversal of unearned compensation upon adoption of SFAS 123(R) (see Note 9)	(364)	(182)	(4,997)	-	-	5,179	-
Share-based compensation expense	-	-	7,578	-	-	-	7,578
Vesting of restricted stock and restricted stock units	149	75	(75)	-	-	-	-
Transition adjustment upon adoption of SFAS 158	-	-	-	-	(381)	-	(381)
	(118)	(59)	(363)	20	-	-	(402)

Other equity transactions							
Predecessor Balances, February 2, 2007	312,436	$ 156,218	$ 486,145	$ 1,103,951	$ (987)	$ 420	$ 1,745,747
Adoption of FIN 48	-	-	-	(8,917)	-	-	(8,917)
Predecessor Balances as adjusted, February 2, 2007	312,436	156,218	486,145	1,095,034	(987)	420	1,736,830
Comprehensive income:							
Net loss	-	-	-	(7,998)	-	-	(7,998)
Reclassification of net loss on derivatives	-	-	-	-	76	-	76
Comprehensive loss	-	-	-	-	-	-	(7,922)
Cash dividends, $0.05 per common share	-	-	-	(15,710)	-	-	(15,710)
Issuance of common stock under stock incentive plans	2,496	1,248	40,294	-	-	-	41,542
Tax benefit from stock option exercises	-	-	3,927	-	-	-	3,927
Share-based compensation expense	-	-	45,458	-	-	-	45,458
Vesting of restricted stock and restricted stock units	126	63	(63)	-	-	-	-
Other equity transactions	(28)	(13)	(580)	(48)	-	7	(634)
Elimination of Predecessor equity in connection with Merger (see Notes 1 and 2)	(315,030)	(157,516)	(575,181)	(1,071,278)	911	(427)	(1,803,491)
Predecessor Balances subsequent to Merger	$ -	$ -	$ -	$ -	$ -	$ -	$ -

	Common Stock Shares	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Other Shareholders' Equity	Total
Successor capital contribution, net	554,035	277,018	2,476,958	-	-	-	2,753,976
Comprehensive loss:							
Net loss	-	-	-	(4,818)	-	-	(4,818)
Unrealized net loss on hedged transactions	-	-	-	-	(49,112)	-	(49,112)
Comprehensive loss							(53,930)
Issuance of common stock under stock incentive plans	574	287	(287)	-	-	-	-
Issuance of restricted common stock under stock incentive plans	890	445	(445)	-	-	-	-
Repurchases of common stock	(17)	(9)	9	-	-	-	-
Share-based compensation expense	-	-	3,827	-	-	-	3,827
Successor Balances, February 1, 2008	555,482	$ 277,741	$ 2,480,062	$ (4,818)	$ (49,112)	-	$ 2,703,873

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

57

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Successor	Predecessor		
	July 7, 2007 through February 1, 2008 (a)	February 3, 2007 through July 6, 2007	Year Ended February 2, 2007	Year Ended February 3, 2006
	(30 weeks)	(22 weeks)	(52 weeks)	(53 weeks)
Cash flows from operating activities:				
Net income (loss)	$ (4,818)	$ (7,998)	$ 137,943	$ 350,155
Adjustments to reconcile net income (loss) to net cash provided by operating activities:				
Depreciation and amortization	150,213	83,917	200,608	186,824
Deferred income taxes	19,551	(20,874)	(38,218)	8,244
Tax benefit from stock option exercises	-	(3,927)	(2,513)	6,457
Loss on debt retirement, net	1,249	-	-	-
Noncash share-based compensation	3,827	45,433	7,578	3,332
Noncash unrealized loss on interest rate swap	3,705	-	-	-
Noncash inventory adjustments and asset impairments	-	-	78,115	-
Change in operating assets and liabilities:				
Merchandise inventories	79,469	16,424	(28,057)	(97,877)
Prepaid expenses and other current assets	3,739	(6,184)	(5,411)	(10,630)
Accounts payable	(41,395)	34,794	53,544	87,230
Accrued expenses and other liabilities	16,061	52,995	38,353	40,376
Income taxes	7,348	2,809	(35,165)	(26,017)
Other	655	4,557	(1,420)	7,391
Net cash provided by operating activities	239,604	201,946	405,357	555,485
Cash flows from investing activities:				
Merger, net of cash acquired	(6,738,391)	-	-	-
Purchases of property and equipment	(83,641)	(56,153)	(261,515)	(284,112)
Purchases of short-term investments	(3,800)	(5,100)	(49,675)	(132,775)
Sales of short-term investments	21,445	9,505	51,525	166,850
Purchases of long-term investments	(7,473)	(15,754)	(25,756)	(16,995)
Purchases of promissory notes	(37,047)	-	-	-
Insurance proceeds related to property and equipment	-	-	1,807	1,210
Proceeds from sale of property and equipment	533	620	1,650	1,419
Net cash used in investing activities	(6,848,374)	(66,882)	(281,964)	(264,403)
Cash flows from financing activities:				
Issuance of common stock	2,759,540	-	-	-
Borrowings under revolving credit facility	1,522,100	-	2,012,700	232,200
Repayments of borrowings under revolving credit facility	(1,419,600)	-	(2,012,700)	(232,200)
Issuance of long-term obligations	4,176,817	-	-	14,495

Repayments of long-term obligations		(241,945)		(4,500)		(14,118)		(14,310)
Debt issuance costs		(87,392)		-		-		-
Payment of cash dividends		-		(15,710)		(62,472)		(56,183)
Proceeds from exercise of stock options		-		41,546		19,894		29,405
Repurchases of common stock		(541)		-		(79,947)		(297,602)
Tax benefit of stock options		-		3,927		2,513		-
Other financing activities		-		-		(584)		892
Net cash provided by (used in) financing activities		6,708,979		25,263		(134,714)		(323,303)
Net increase (decrease) in cash and cash equivalents		100,209		160,327		(11,321)		(32,221)
Cash and cash equivalents, beginning of period		-		189,288		200,609		232,830
Cash and cash equivalents, end of period	$	100,209	$	349,615	$	189,288	$	200,609
Supplemental cash flow information:								
Cash paid (received) for:								
Interest	$	226,738	$	11,246	$	24,180	$	25,747
Income taxes	$	(30,574)	$	26,012	$	155,825	$	205,802
Supplemental schedule of noncash investing and financing activities:								
Purchases of property and equipment awaiting processing for payment, included in Accounts payable	$	20,449	$	13,544	$	18,094	$	24,750
Exchange of shares and stock options in business combination	$	7,685	$	-	$	-	$	-
Purchases of property and equipment under capital lease obligations	$	592	$	1,036	$	5,366	$	7,197
Elimination of financing obligations (See Note 7)	$	-	$	-	$	46,608	$	-
Elimination of promissory notes receivable (See Note 7)	$	-	$	-	$	46,608	$	-

(a) Includes the cash flows of Buck Acquisition Corp. for the period prior to its merger with and into Dollar General Corporation from March 6, 2007 (its formation) through July 6, 2007 (which were zero), and the post-merger results of Dollar General Corporation for the period from July 7, 2007 through February 1, 2008. See Notes 1 and 2.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of presentation and accounting policies

Basis of presentation

These notes contain references to the years 2008, 2007, 2006, and 2005, which represent fiscal years ending or ended January 30, 2009, February 1, 2008, February 2, 2007, and February 3, 2006, respectively. Fiscal 2008 will be, and each of fiscal years 2007 and 2006 were, a 52-week accounting period while fiscal 2005 was a 53-week accounting period. The Company's fiscal year ends on the Friday closest to January 31. The consolidated financial statements include all subsidiaries of the Company, except for its not-for-profit subsidiary the assets and revenues of which are not material. Intercompany transactions have been eliminated.

Dollar General Corporation (the "Company") was acquired on July 6, 2007 through a Merger (as defined and discussed in greater detail in Note 2 below) accounted for as a reverse acquisition. Although the Company continued as the same legal entity after the Merger, the accompanying consolidated financial statements are presented for the "Predecessor" and "Successor" relating to the periods preceding and succeeding the Merger, respectively. As a result of the Company applying purchase accounting and a new basis of accounting beginning on July 7, 2007, the financial reporting periods presented are as follows:

· The 2007 periods presented include the 22-week Predecessor period of the Company from February 3, 2007 to July 6, 2007 and the 30-week Successor period, reflecting the merger of the Company and Buck Acquisition Corp. ("Buck") from July 7, 2007 to February 1, 2008.

· Buck's results of operations for the period from March 6, 2007 to July 6, 2007 (prior to the Merger on July 6, 2007) are also included in the consolidated financial statements for the Successor period described above as a result of certain derivative financial instruments entered into by Buck prior to the Merger, as further described below. Other than these financial instruments, Buck had no assets, liabilities, or operations prior to the Merger.

· The 2006 and 2005 periods presented reflect the Predecessor. The consolidated financial statements for the Predecessor periods have been prepared using the Company's historical basis of accounting. As a result of purchase accounting, the pre-Merger and post-Merger consolidated financial statements are not comparable.

The Company leases three of its distribution centers ("DCs") from lessors, which meet the definition of a Variable Interest Entity ("VIE") as described by Financial Accounting Standards Board ("FASB") Interpretation 46, "Consolidation of Variable Interest Entities" ("FIN 46"), as revised. One of these DCs has been recorded as a financing obligation whereby the property and equipment, along with the related lease obligations, are reflected in the consolidated balance sheets. The land and buildings of the other two DCs have been recorded as operating leases in accordance with Statement of Financial Accounting Standards ("SFAS") 13, "Accounting for Leases." The Company is not the primary beneficiary of these VIEs and, accordingly, has not included these entities in its consolidated financial statements.

Business description

The Company sells general merchandise on a retail basis through 8,194 stores (as of February 1, 2008) located primarily in the southern, southwestern, midwestern and eastern United States. The Company has DCs in Scottsville, Kentucky; Ardmore, Oklahoma; South Boston, Virginia; Indianola, Mississippi; Fulton, Missouri; Alachua, Florida; Zanesville, Ohio; Jonesville, South Carolina and Marion, Indiana.

The Company purchases its merchandise from a wide variety of suppliers. Approximately 12% of the Company's purchases in 2007 were made from The Procter & Gamble Company. The Company's next largest supplier accounted for approximately 6% of the Company's purchases in 2007.

Cash and cash equivalents

Cash and cash equivalents include highly liquid investments with insignificant interest rate risk and original maturities of three months or less when purchased. Such investments primarily consist of money market funds, certificates of deposit (which may include foreign time deposits), and commercial paper. The carrying amounts of these items are a reasonable estimate of their fair value due to the short maturity of these investments. The Company held foreign time deposits of $5.2 million as of February 1, 2008.

Payments due from banks for third-party credit card, debit card and electronic benefit transactions classified as cash and cash equivalents totaled approximately $13.9 million and $11.6 million at February 1, 2008 and February 2, 2007, respectively.

The Company's cash management system provides for daily investment of available balances and the funding of outstanding checks when presented for payment. Outstanding but unpresented checks totaling approximately $107.9 million and $122.3 million at February 1, 2008 and February 2, 2007, respectively, have been included in Accounts payable in the consolidated balance sheets. Upon presentation for payment, these checks are funded through available cash balances or the Company's credit facilities.

The Company has certain cash and cash equivalents balances that, along with certain other assets, are being held as required by certain insurance-related regulatory requirements and are therefore not available for general corporate purposes, as further described below under "Investments in debt and equity securities."

Investments in debt and equity securities

The Company accounts for its investment in debt and marketable equity securities in accordance with SFAS 115, "Accounting for Certain Investments in Debt and Equity Securities," and accordingly, classifies them as held-to-maturity, available-for-sale, or trading. Debt securities categorized as held-to-maturity are stated at amortized cost. Debt and equity securities categorized as available-for-sale are stated at fair value, with any unrealized gains and losses, net of deferred income taxes, reported as a component of Accumulated other comprehensive loss. Trading securities (primarily mutual funds held pursuant to deferred compensation and supplemental retirement plans, as further discussed in Note 8) are stated at fair value, with changes in fair value recorded in income as a component of Selling, general and administrative ("SG&A") expense.

In general, the Company invests excess cash in shorter-dated, highly liquid investments such as money market funds, certificates of deposit, and commercial paper. Such securities have been classified either as held-to-maturity or available-for-sale, depending on the type of securities purchased (debt versus equity) as well as the Company's intentions with respect to the potential sale of such securities before their stated maturity dates. Given the short maturities of such investments (except for those securities described in further detail below), the carrying amounts approximate the fair values of such securities.

In 2006 and prior years, the Company invested in tax-exempt auction rate securities, which are debt instruments having longer-dated (in some cases, many years) legal maturities, but with interest rates that are generally reset every 28-35 days under an auction system. Because auction rate securities are frequently re-priced, they trade in the market like short-term investments. As available-for-sale securities, these investments are carried at fair value, which approximates cost given that the average duration of such securities held by the Company is less than 40 days. Despite the liquid nature of these investments, the Company categorizes them as short-term investments instead of cash and cash equivalents due to the underlying legal maturities of such securities. However, they have been classified as current assets as they are generally available to support the Company's current operations. There were no such investments outstanding as of February 1, 2008 or February 2, 2007.

In 2007 and 2006, the Company's South Carolina-based wholly owned captive insurance subsidiary, Ashley River Insurance Company ("ARIC"), had investments in U.S. Government securities, obligations of Government Sponsored Enterprises, short- and long-term corporate obligations, and asset-backed obligations. These investments are held pursuant to South Carolina regulatory requirements to maintain certain asset balances in relation to ARIC's liability and equity balances and, as such, these investments are not available for general corporate purposes. The composition of these required asset balances changes periodically. At February 1, 2008, the total of these balances was $63.4 million and is reflected in the Company's consolidated balance sheet as follows: cash and cash equivalents of $11.9 million, short-term investments of $19.6 million and long-term investments included in other assets of $31.9 million.

Historical cost information pertaining to investments in mutual funds by participants in the Company's supplemental retirement and compensation deferral plans classified as trading securities is not readily available to the Company.

On February 1, 2008 and February 2, 2007, held-to-maturity, available-for-sale and trading securities consisted of the following (in thousands):

Successor		Gross Unrealized		Estimated
February 1, 2008	Cost	Gains	Losses	Fair Value
Held-to-maturity securities				
Bank and corporate debt	$ 24,254	$ 244	$ 107	$ 24,391
U.S. Government securities	16,652	676	-	17,328
Obligations of Government sponsored enterprises	9,834	40	-	9,874
Asset-backed securities	1,815	21	5	1,831
Other debt securities (see Note 7)	33,453	-	709	32,744
	86,008	981	821	86,168
Trading securities				
Equity securities	15,066	-	-	15,066
Total debt and equity securities	$ 101,074	$ 981	$ 821	$ 101,234

Predecessor		Gross Unrealized		Estimated
February 2, 2007	Cost	Gains	Losses	Fair Value
Held-to-maturity securities				
Bank and corporate debt	$ 100,386	$ 2	$ 80	$ 100,308
U.S. Government securities	17,026	1	29	16,998
Obligations of Government sponsored enterprises	9,192	3	9	9,186
Asset-backed securities	2,833	4	10	2,827
	129,437	10	128	129,319
Available-for-sale securities				
Equity securities	13,512	-	-	13,512
Trading securities				
Equity securities	13,591	-	-	13,591
Total debt and equity securities	$ 156,540	$ 10	$ 128	$ 156,422

On February 1, 2008 and February 2, 2007, these investments were included in the following accounts in the consolidated balance sheets (in thousands):

Successor February 1, 2008	Held-to-Maturity Securities	Available-for-Sale Securities	Trading Securities
Cash and cash equivalents	$ 1,000	$ -	$ -
Short-term investments	19,611	-	-
Prepaid expenses and other current assets	-	-	2,166
Other assets, net	31,944	-	12,900
Long-term obligations (see Note 7)	33,453	-	-
	$ 86,008	$ -	$ 15,066

Predecessor February 2, 2007	Held-to-Maturity Securities	Available-for-Sale Securities	Trading Securities
Cash and cash equivalents	$ 79,764	$ 13,512	$ -
Short-term investments	29,950	-	-
Prepaid expenses and other current assets	-	-	1,090
Other assets, net	19,723	-	12,501
	$ 129,437	$ 13,512	$ 13,591

The contractual maturities of held-to-maturity securities as of February 1, 2008 were as follows (in thousands):

Successor	Cost	Fair Value
Less than one year	$ 20,522	$ 20,614
One to three years	31,021	31,790
Greater than three years	34,465	33,764
	$ 86,008	$ 86,168

For the years ended February 1, 2008, February 2, 2007 and February 3, 2006, gross realized gains and losses on the sales of available-for-sale securities were not material. The cost of securities sold is based upon the specific identification method.

Merchandise inventories

Inventories are stated at the lower of cost or market with cost determined using the retail last-in, first-out ("LIFO") method. Under the Company's retail inventory method ("RIM"), the calculation of gross profit and the resulting valuation of inventories at cost are computed by applying a calculated cost-to-retail inventory ratio to the retail value of sales. The excess of current cost over LIFO cost was approximately $6.1 million at February 1, 2008 and $4.3 million at February 2, 2007. Current cost is determined using the retail first-in, first-out method. The Company's LIFO reserves were adjusted to zero at July 6, 2007 as a result of the Merger. The Successor recorded LIFO reserves of $6.1 million during 2007. LIFO reserves of the Predecessor decreased $1.5 million and $0.5 million in 2006 and 2005, respectively. Costs directly associated with warehousing and distribution are capitalized into inventory.

In 2005, the Company expanded the number of inventory departments it utilizes for its gross profit calculation from 10 to 23. The impact of this change in estimate on the Company's consolidated 2005 results of operations was an estimated reduction of gross profit and a corresponding decrease to inventory, at cost, of $5.2 million.

Store pre-opening costs

Pre-opening costs related to new store openings and the construction periods are expensed as incurred.

Property and equipment

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

Land improvements	20
Buildings	39-40
Furniture, fixtures and equipment	3-10

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

Impairment of long-lived assets

When indicators of impairment are present, the Company evaluates the carrying value of long-lived assets, other than goodwill, in relation to the operating performance and future cash flows or the appraised values of the underlying assets. In accordance with SFAS 144, “Accounting for the Impairment or Disposal of Long-Lived Assets,” the Company reviews for impairment stores open more than two years for which current cash flows from operations are negative. Impairment results when the carrying value of the assets exceeds the undiscounted future cash flows over the life of the lease. The Company’s estimate of undiscounted future cash flows over the lease term is based upon historical operations of the stores and estimates of future store profitability which encompasses many factors that are subject to variability and difficult to predict. If a long-lived asset is found to be impaired, the amount recognized for impairment is equal to the difference between the carrying value and the asset’s fair value. The fair value is estimated based primarily upon future cash flows (discounted at the Company’s credit adjusted risk-free rate) or other reasonable estimates of fair market value. Assets to be disposed of are adjusted to the fair value less the cost to sell if less than the book value.

The Company recorded impairment charges included in SG&A expense of approximately $0.2 million in the 2007 Predecessor period, $9.4 million in 2006 and $0.6 million in 2005 to reduce the carrying value of certain of its stores’ assets as deemed necessary due to negative sales trends and cash flows at these locations. The majority of the 2006 charges were recorded pursuant to certain strategic initiatives discussed in Note 3.

Goodwill and other intangible assets

The Company amortizes intangible assets over their estimated useful lives unless such lives are deemed indefinite. Amortizable intangible assets are tested for impairment based on undiscounted cash flows, and, if impaired, written down to fair value based on either discounted cash flows or appraised values. Intangible assets with indefinite lives are tested annually for impairment and written down to fair value as required. No impairment of intangible assets has been identified during any of the periods presented.

Other assets

Other assets consist primarily of long-term investments, qualifying prepaid expenses, debt issuance costs which are amortized over the life of the related obligations, utility and security deposits and life insurance policies. Such debt issuance costs increased substantially subsequent to the Merger as further discussed in Notes 2 and 6.

Vendor rebates

The Company accounts for all cash consideration received from vendors in accordance with the provisions of Emerging Issues Task Force Issue (“EITF”) 02-16, “Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor.” Cash consideration received from a vendor is generally presumed to be a rebate or an allowance and is accounted for as a reduction of merchandise purchase costs and recognized in the statement of operations at the time the goods are sold. However, certain specific, incremental and otherwise qualifying SG&A expenses related to the promotion or sale of vendor products may be offset by cash consideration received from vendors, in accordance with arrangements such as cooperative advertising, when earned for dollar amounts up to but not exceeding actual incremental costs. The Company recognizes amounts received for cooperative advertising on performance, “first showing” or distribution, consistent with its policy for advertising expense in accordance with the American Institute of Certified Public Accountants Statement of Position 93-7, “Reporting on Advertising Costs.”

Rent expense

Rent expense is recognized over the term of the lease. The Company records minimum rental expense on a straight-line basis over the base, non-cancelable lease term commencing on the date that the Company takes physical possession of the property from the landlord, which normally includes a period prior to the store opening to make necessary leasehold improvements and install store fixtures. When a lease contains a predetermined fixed escalation of the minimum rent, the Company recognizes the related rent expense on a straight-line basis and records the difference between the recognized rental expense and the amounts payable under the lease as deferred rent. The Company also receives tenant allowances, which are recorded as deferred incentive rent and are amortized as a reduction to rent expense over the term of the lease. Any difference between the calculated expense and the amounts actually paid are reflected as a liability, with the current portion in Accrued expenses and other and the long-term portion in Other liabilities in the consolidated balance sheets, and totaled approximately $3.7 million (after purchase accounting adjustment due to the Merger) and $30.4 million at February 1, 2008 and February 2, 2007, respectively.

The Company recognizes contingent rental expense when the achievement of specified sales targets are considered probable, in accordance with EITF Issue 98-9, “Accounting for Contingent Rent.” The amount expensed but not paid as of February 1, 2008 and February 2, 2007 was approximately $8.3 million and $8.6 million, respectively, and is included in Accrued expenses and other in the consolidated balance sheets (See Note 7).

Generally, for store closures where a lease obligation still exists, the Company records the estimated future liability associated with the rental obligation on the date the store is closed in accordance with SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities." The estimated future liability associated with the rental obligation for certain store closures associated with the Merger were based on EITF 95-3, "Recognition of Liabilities in Connection with a Purchase Business Combination." In the normal course of business, based on an overall analysis of store performance and expected trends, management periodically evaluates the need to close underperforming stores. 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. Liabilities are reviewed periodically and adjusted when necessary. The closed store liability balance at February 1, 2008 and February 2, 2007 was $20.2 million and $5.4 million, respectively.

Accrued expenses and other liabilities

Accrued expenses and other consist of the following:

(In thousands)	Successor 2007	Predecessor 2006
Compensation and benefits	$ 60,720	$ 41,957
Insurance	64,418	76,062
Taxes (other than taxes on income)	55,990	50,502
Other	119,828	85,037
	$ 300,956	$ 253,558

Other accrued expenses primarily include the current portion of liabilities for deferred rent, freight expense, contingent rent expense, interest, electricity, lease contract termination liabilities for closed stores, income tax related reserves, and common area maintenance charges.

Insurance liabilities

The Company retains a significant portion of risk for its workers' compensation, employee health, general liability, property and automobile claim exposures. Accordingly, provisions are made for the Company's estimates of such risks. The undiscounted future claim costs for the workers' compensation, general liability, and health claim risks are derived using actuarial methods. To the extent that subsequent claim costs vary from those estimates, future results of operations will be affected. Ashley River Insurance Company (or ARIC, as defined above), a South Carolina-based wholly owned captive insurance subsidiary of the Company, charges the operating subsidiary companies premiums to insure the retained workers' compensation and non-property general liability exposures. Pursuant to South Carolina insurance regulations, ARIC has cash and cash equivalents and investment balances that are not available for general corporate purposes, as further described above under "Investments in debt and equity securities." ARIC currently insures no unrelated third-party risk.

As a result of the Merger, the Company recorded its assumed self-insurance reserves as of the Merger date at their present value in accordance with SFAS 141, "Business Combinations", using a discount rate of 5.4%. The balance of the resulting discount was $18.7 million at February 1, 2008. Other than for reserves assumed in a business combination, the Company's policy is to record self-insurance reserves on an undiscounted basis.

Other liabilities

Other non-current liabilities consist of the following:

(In thousands)	Successor 2007	Predecessor 2006
Compensation and benefits	$ 13,744	$ 15,344
Insurance	123,276	107,476
Income tax related reserves	78,277	-
Derivatives	82,319	-
Other	22,098	35,521
	$ 319,714	$ 158,341

Other liabilities consist primarily of deferred rent, lease contract termination liabilities for closed stores, leasehold interests liabilities, and redeemable stock options.

Fair value of financial instruments

The carrying amounts reflected in the consolidated balance sheets for cash, cash equivalents, short-term investments, receivables and payables approximate their respective fair values. At February 1, 2008, the fair value of the Company's debt, excluding capital lease obligations, was approximately $3,782.6 million, or approximately $489.2 million less than the carrying values of the debt, compared to a fair value of $265.7 million at February 2, 2007, or approximately $14.0 million greater than the carrying value. The fair value (estimated market value) of the debt is based primarily on quoted prices for those or similar instruments.

The fair value of the Company's derivatives reflects the estimated amounts that the Company would receive or pay to terminate these contracts at the reporting date based upon pricing or valuation models applied to current market information. Interest rate swaps are valued using the market standard methodology of netting the discounted future fixed cash receipts (or payments) and the discounted expected variable cash payments (or receipts). The variable cash payments (or receipts) are based on an expectation of future interest rates derived from observed market interest rate curves.

Derivative financial instruments

The Company accounts for derivative financial instruments in accordance with SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities", as amended and interpreted (collectively, "SFAS 133"). This literature requires the Company to recognize all derivative instruments on the balance sheet at fair value, and contains accounting rules for hedging instruments, which depend on the nature of the hedge relationship. All financial instrument positions taken by the Company are intended to be used to reduce risk by hedging an underlying economic exposure.

The Company's derivative financial instruments, in the form of interest rate swaps, are related to variable interest rate risk exposures associated with the Company's long-term debt and were entered into in an attempt to manage that risk. The counterparties to the Company's derivative agreements are all major international financial institutions. The Company continually monitors its position and the credit ratings of its counterparties and does not anticipate nonperformance by the counterparties. The Company does not offset fair value amounts of derivatives and associated cash collateral.

In April 2007, Buck entered into interest rate swaps, contingent upon the completion of the Merger, on a portion of the loans anticipated to result from the Merger. The interest rate swaps result in the Company paying a fixed rate of 7.683% on a notional amount of $2.0 billion as of July 31, 2007, with the notional amount of these swaps amortizing on a quarterly basis through July 31, 2012. Such notional amount was $1.6 billion as of February 1, 2008. The swaps were designated as cash flow hedges on October 12, 2007. For the period prior to hedge designation, an unrealized loss of $3.7 million for the Successor period has been recognized in Loss on interest rate swaps in the consolidated statements of operations, reflecting the changes in fair value of the swaps prior to their designation as qualifying cash flow hedging relationships, which were offset by earnings under the contractual provisions of the swaps of $1.7 million during the same time period.

As of February 1, 2008, the fair value of the interest rate swaps of ($82.3) million was recorded in non-current Other liabilities on the consolidated balance sheet. From the date the swaps were designated as hedges, the effective portion of the change in fair value of the swaps of ($78.6) million was recorded in Other comprehensive income, a separate component of equity, offset by related income taxes of $29.5 million. The Company also recorded expense related to hedge ineffectiveness of $0.4 million during the Successor period ended February 1, 2008.

Share-based payments

Effective February 4, 2006, the Company adopted SFAS 123 (Revised 2004) "Share Based Payment" ("SFAS 123(R)") and began recognizing compensation expense for share-based compensation based on the fair value of the awards on the grant date. SFAS 123(R) requires share-based compensation expense recognized since February 4, 2006 to be based on: (a) grant date fair value estimated in accordance with the original provisions of SFAS 123, "Accounting for Stock-Based Compensation," for unvested options granted prior to the adoption date and (b) grant date fair value estimated in accordance with the provisions of SFAS 123(R) for unvested options granted after the adoption date. The Company adopted SFAS 123(R) under the modified-prospective-transition method and, therefore, results from prior periods have not been restated.

Prior to February 4, 2006, the Company accounted for share-based payments using the intrinsic-value-based recognition method prescribed by Accounting Principles Board Opinion 25, "Accounting for Stock Issued to Employees" ("APB 25"), and provided pro forma disclosures as permitted under SFAS 123. Because options were granted at an exercise price equal to the market price of the underlying common stock on the grant date, compensation cost related to stock options was generally not required to be recorded as a reduction to net income prior to the adoption of SFAS 123(R).

Under SFAS 123(R), forfeitures are estimated at the time of valuation and reduce expense ratably over the vesting period. This estimate is adjusted periodically based on the extent to which actual forfeitures differ, or are expected to differ, from the prior estimate. The forfeiture rate is the estimated percentage of options granted that are expected to be forfeited or canceled before becoming fully vested. The Company bases this estimate on historical experience or estimates of future trends, as applicable. An increase in the forfeiture rate will decrease compensation expense. Under SFAS 123, the Company elected to account for forfeitures when awards were actually forfeited.

SFAS 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required prior to the adoption of SFAS 123(R).

The fair value of each option grant is separately estimated and amortized into compensation expense on a straight-line basis between the applicable grant date and each vesting date. The Company has estimated the fair value of all stock option awards as of the grant date 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 Company also accounts for nonvested restricted stock 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 grant date 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. Under the provisions of SFAS 123(R), unearned compensation is not recorded within shareholders' equity.

The Company has elected to determine its excess tax benefit pool upon adoption of SFAS 123(R) in accordance with the provisions of FASB Staff Position ("FSP") 123(R)-3, "Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards." Under the provisions of this FSP, the cumulative benefit of stock option exercises included in additional paid-in capital for the periods after the effective date of SFAS 123 is reduced by the cumulative income tax effect of the pro forma stock option expense previously disclosed in accordance with the requirements of SFAS 123. (The provision of this FSP applied only to options that were fully vested before the date of adoption of SFAS 123(R). The amount of any excess tax benefit for options that are either granted after the adoption of SFAS 123(R) or are partially vested on the date of adoption were computed in accordance with the provisions of SFAS 123(R).) The amount of any excess deferred tax asset over the actual income tax benefit realized for options that are exercised after the adoption of SFAS 123(R) will be absorbed by the excess tax benefit pool. Income tax expense will be increased should the Company's excess tax benefit pool be insufficient to absorb any future deferred tax asset amounts in excess of the actual tax benefit realized. The Company has determined that its excess tax benefit pool was approximately $68 million as of the adoption of SFAS 123(R) on February 4, 2006. After the Merger and the related application of purchase accounting, the excess tax benefit pool has been reduced to zero.

Revenue and gain recognition

The Company recognizes retail sales in its stores at the time the customer takes possession of merchandise. All sales are net of discounts and estimated returns and are presented net of taxes assessed by governmental authorities that are imposed concurrent with those sales. The liability for retail merchandise returns is based on the Company's prior experience. The Company records gain contingencies when realized.

The Company began gift card sales in the third quarter of 2005. The Company recognizes gift card sales revenue at the time of redemption. The liability for the gift cards is established for the cash value at the time of purchase. The liability for outstanding gift cards was approximately $1.2 million and $0.8 million at February 1, 2008 and February 2, 2007, respectively, and is recorded in Accrued expenses and other. Through February 1, 2008, the Company has not recorded any breakage income related to its gift card program. The Company will continue to evaluate its current breakage policy as it continues to gain more sufficient company-specific customer experience.

Advertising costs

Advertising costs are expensed upon performance, "first showing" or distribution, and are reflected net of qualifying cooperative advertising funds provided by vendors in SG&A expenses. Advertising costs were $23.6 million $17.3 million, $45.0 million and $15.1 million in the 2007 Successor and Predecessor periods, 2006 and 2005, respectively. These costs primarily include promotional circulars, targeted circulars supporting new stores, television and radio advertising, in-store signage, and costs associated with the sponsorship of a National Association for Stock Car Auto Racing team. Vendor funding for cooperative advertising offset reported expenses by $6.6 million, $2.0 million, $7.9 million and $0.8 million in the 2007 Successor and Predecessor periods, 2006 and 2005, respectively.

Capitalized interest

To assure that interest costs properly reflect only that portion relating to current operations, interest on borrowed funds during the construction of property and equipment is capitalized. Interest costs capitalized were approximately $2.9 million and $3.3 million in 2006 and 2005, respectively.

Income taxes

The Company reports income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes" ("SFAS 109"). Under SFAS 109, the asset and liability method is used for computing the future income tax consequences of events that have been recognized in the Company's consolidated financial statements or income tax returns. Deferred income tax expense or benefit is the net change during the year in the Company's deferred income tax assets and liabilities.

As discussed in Note 5, effective February 3, 2007 the Predecessor modified its method of accounting for income taxes in connection with the adoption of FASB Interpretation 48, Accounting for Uncertainty in Income Taxes – An Interpretation of FASB Statement 109 ("FIN 48"). 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 the Company's effective income tax rate if the Company were to recognize the tax benefit for these positions. After the Merger and the related application of purchase accounting, no portion of the reserve for uncertain tax positions that existed as of the date of adoption would impact our effective tax rate but would, if subsequently recognized, reduce the amount of goodwill recorded in relation to the Merger.

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.

Income tax reserves are determined using the methodology established by FIN 48. FIN 48 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 the Company's determinations and estimates prove to be inaccurate, the resulting adjustments could be material to the Company's future financial results.

Management estimates

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Accounting pronouncements

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities", an amendment of FASB Statement No. 133. SFAS 161 applies to all derivative instruments and nonderivative instruments that are designated and qualify as hedging instruments pursuant to paragraphs 37 and 42 of SFAS 133 and related hedged items accounted for under SFAS 133. SFAS 161 requires entities to provide greater transparency through additional disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations, and how derivative instruments and related hedged items affect an entity's financial position, results of operations, and cash flows. SFAS 161 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2008. The Company currently plans to adopt SFAS 161 during its 2009 fiscal year. No determination has yet been made regarding the potential impact of this standard on the Company's financial statements.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations". The new standard establishes the requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest (formerly minority interest) in an acquiree; provides updated requirements for recognition and measurement of goodwill acquired in a business combination or a gain from a bargain purchase; and provides updated disclosure requirements to enable users of financial statements to evaluate the nature and financial effects of the business combination. This Statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Early adoption is not allowed. This standard is not expected to impact the Company's financial statements unless a qualifying transaction is consummated subsequent to the effective date.

In February 2007, the FASB issued SFAS 159, "The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115" ("SFAS 159"). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. It provides entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company currently plans to adopt SFAS 159 during its 2008 fiscal year. The Company is in the process of evaluating the potential impact of this standard on its financial statements.

In September 2006, the FASB issued SFAS 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 provides guidance for using fair value to measure assets and liabilities. The standard also requires expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. The standard applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances for financial assets and liabilities. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. For non-financial assets and liabilities, the effective date has been delayed to fiscal years beginning after November 15, 2008. The Company currently plans to adopt SFAS 157 during its 2008 and 2009 fiscal years as appropriate. The Company is in the process of evaluating the potential impact of this standard on its financial statements.

Reclassifications

Certain reclassifications of the 2006 amounts have been made to conform to the 2007 presentation.

2. 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, a Tennessee corporation and wholly owned subsidiary of Parent. Parent is and Buck was (prior to the Merger) controlled by investment funds affiliated with Kohlberg Kravis Roberts & Co., L.P. (“KKR”). On July 6, 2007, the transaction was consummated through a merger (the “Merger”) of Buck with and into the Company. The Company survived the Merger as a subsidiary of Parent. The Company’s results of operations after July 6, 2007 include the effects of the Merger.

The aggregate purchase price was approximately $7.1 billion, including direct costs of the Merger, and was funded primarily through debt financings as described more fully below in Note 6 and cash equity contributions from KKR, GS Capital Partners VI Fund, L.P. and affiliated funds (affiliates of Goldman, Sachs & Co.), Citi Private Equity, Wellington Management Company, LLP, CPP Investment Board (USRE II) Inc., and other equity co-investors (collectively, the “Investors”) of approximately $2.8 billion (553.4 million shares of new common stock, $0.50 par value per share, valued at $5.00 per share). Also in connection with the Merger, certain of the Company’s management employees invested, and were issued new shares representing less than 1% of the outstanding shares, in the Company. Pursuant to the terms of the Merger Agreement, the former holders of the Company’s common stock, par value $0.50 per share, received $22.00 per share, or approximately $6.9 billion, and all such shares were acquired as a result of the Merger. As of February 1, 2008, there were approximately 555,481,897 shares of Company common stock outstanding, a portion of which is redeemable as further discussed below in Note 9.

As discussed in Note 1, the Merger was accounted for as a reverse acquisition in accordance with the purchase accounting provisions of SFAS 141, “Business Combinations”. Because of this accounting treatment, the Company’s assets and liabilities have properly been accounted for at their estimated fair values as of the Merger date. The aggregate purchase price has been allocated to the tangible and intangible assets acquired and liabilities assumed based upon an assessment of their relative fair values as of the Merger date.

The allocation of the purchase price is as follows (in thousands):

Cash and cash equivalents	$ 349,615
Short-term investments	30,906
Merchandise inventories	1,368,130
Income taxes receivable	36,934
Deferred income taxes	57,176
Prepaid expenses and other current assets	63,204
Property and equipment, net	1,301,119
Goodwill	4,344,930
Intangible assets	1,396,612
Other assets, net	66,537
Current portion of long-term obligations	(7,088)
Accounts payable	(585,518)
Accrued expenses and other	(306,394)
Income taxes payable	(84)
Long-term obligations	(267,927)
Deferred income taxes	(536,555)
Other liabilities	(215,906)
Total purchase price assigned	$ 7,095,691

The purchase price allocation as of February 1, 2008 included approximately $4.34 billion of goodwill, none of which is expected to be deductible for tax purposes. The goodwill balance at February 1, 2008 increased by $21.3 million over the balance reported at August 3, 2007, representing a refinement of the purchase price allocation related to the Merger. The February 1, 2008 purchase price allocation also included approximately $1.4 billion of other intangible assets, as follows:

	As of February 1, 2008			
(In thousands)	Estimated Useful Life	Gross Carrying Amount	Accumulated Amortization	Net
Leasehold interests	2 to 17.5 years	$ 185,112	$ 23,663	$ 161,449
Internally developed software	3 years	12,300	2,392	9,908
		197,412	26,055	171,357
Trade names and trademarks	Indefinite	1,199,200	-	1,199,200
		$ 1,396,612	$ 26,055	$ 1,370,557

The Company recorded amortization expense related to amortizable intangible assets for the year-to-date Successor period ended February 1, 2008 of $26.1 million ($23.7 million of which is included in rent expense). Amortizable intangible assets will be amortized over a weighted average period of 5.4 years.

For intangible assets subject to amortization, the estimated aggregate amortization expense for each of the five succeeding fiscal years is as follows: 2008 - $44.7 million, 2009 - $41.2 million, 2010 - $27.3 million, 2011 - $21.0 million, 2012 - $17.1 million.

Fees and expenses related to the Merger totaled $102.6 million, principally consisting of investment banking fees, legal fees and stock compensation ($39.4 million as further discussed in Note 9), and are reflected in the 2007 results of operations. Capitalized debt issuance costs, related to financing the Merger of $87.4 million as of the Merger date are reflected in other long-term assets in the consolidated balance sheet.

74

The following represents the unaudited pro forma results of our consolidated operations as if the Merger had occurred on February 4, 2006, after giving effect to certain adjustments, including the depreciation and amortization of the assets acquired based on their estimated fair values and changes in interest expense resulting from changes in consolidated debt (in thousands):

(In thousands)	Year Ended February 1, 2008	Year ended February 2, 2007
Revenue	$ 9,495,246	$ 9,169,822
Net loss	(57,939)	(156,188)

The pro forma information does not purport to be indicative of what the Company's results of operations would have been if the acquisition had in fact occurred at the beginning of the periods presented, and is not intended to be a projection of the Company's future results of operations.

Subsequent to the announcement of the Merger Agreement, the Company and its directors, along with other parties, were named in seven putative class actions filed in Tennessee state courts alleging claims for breach of fiduciary duty arising out of the proposed Merger, all as described more fully under “Legal Proceedings” in Note 7 below.

3. Strategic initiatives

During 2006, the Company began implementing certain strategic initiatives related to its historical inventory management and real estate strategies, as more fully described below.

Inventory management

In November 2006, the Company undertook an initiative to discontinue its historical inventory packaway model for virtually all merchandise by the end of fiscal 2007. Under the packaway model, unsold inventory items were stored on-site and returned to the sales floor to be sold year after year, until the items were eventually sold, damaged or discarded. Through end-of-season and other markdowns, this initiative resulted in the elimination of seasonal, home products and basic clothing packaway merchandise to allow for increased levels of newer, current-season merchandise. In connection with this strategic change, in the third quarter of 2006 the Company recorded a reserve for lower of cost or market inventory impairment estimates of $63.5 million and incurred higher markdowns and writedowns on inventory in the second half of 2006 and in 2007 than in comparable prior-year periods. As a result of the Merger and in accordance with SFAS 141, the Company’s inventory balances, including the inventory associated with this strategic change, were adjusted to fair value and the related reserve was eliminated.

Exit and disposal activities

In November 2006, the Company decided 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, all of which have been closed as of February 1, 2008. Additionally, in connection with the Merger, management approved and completed a plan to close an additional 60 stores prior to February 1, 2008. The Company has recorded the following pre-tax costs associated with the closing of these approximately 460 stores (in millions):

	Total (a)	Incurred in 2006	Incurred in 2007	Merger Additions (b)	Remaining
Lease contract termination costs (c)	$ 34.3	$ 5.7	$ 16.3	$ 12.3	$ -
One-time employee termination benefits	1.0	0.3	0.5	0.2	-
Other associated store closing costs	8.6	0.2	7.2	1.2	-
Inventory liquidation fees	4.4	1.6	2.8	-	-
Asset impairment & accelerated depreciation	12.8	8.3	3.6	0.9	-
Inventory markdowns below cost	8.3	6.7	0.9	0.7	-
Total	$ 69.4	$ 22.8	$ 31.3	$ 15.3	$ -

(a) Reflects totals as of February 1, 2008, which, in total, are $1.5 million less than estimates as of November 2, 2007.
(b) These amounts were recorded as assumed liabilities in connection with the Merger.
(c) Including reversals of deferred rent accruals totaling $0.5 million, of which $0.1 million is reflected in 2006, and $0.4 million is reflected in 2007. Excludes accretion expense to be incurred in future periods.

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 exit activities discussed above are as follows (in millions):

	Balance, February 2, 2007	2007 Expenses (a)	2007 Payments and Other	Merger Additions (b)	Balance, February 1, 2008
Lease contract termination costs	$ 5.0	$ 16.9	$ 14.1	$ 12.3	$ 20.1
One-time employee termination benefits	0.3	0.5	1.0	0.2	-
Other associated store closing costs (c)	0.2	7.2	7.6	1.2	1.0
Inventory liquidation fees	0.3	2.8	3.1	-	-
Total	$ 5.8	$ 27.4	$ 25.8	$ 13.7	$ 21.1

(a) 2007 expenses associated with exit and disposal activities are included in selling, general and administrative ("SG&A") expenses in the consolidated statement of operations.
(b) These amounts were recorded as assumed liabilities in connection with the Merger.

(c) Primarily represents store closing costs including removal of store fixtures.

4. Property and equipment

Property and equipment is recorded at cost and summarized as follows:

(In thousands)	Successor 2007	Predecessor 2006
Land and land improvements	$ 137,539	$ 147,447
Buildings	516,482	437,368
Leasehold improvements	87,343	212,078
Furniture, fixtures and equipment	645,376	1,617,163
Construction in progress	2,823	16,755
	1,389,563	2,430,811
Less accumulated depreciation and amortization	115,318	1,193,937
Net property and equipment	$ 1,274,245	$ 1,236,874

Depreciation expense related to property and equipment was approximately $116.9 million for the Successor period from July 7, 2007 through February 1, 2008 compared to $83.5 million for the February 3, 2007 through July 6, 2007 Predecessor period, $199.6 million for 2006 and $186.1 million for 2005. Amortization of capital lease assets is included in depreciation expense.

5. Income taxes

The provision (benefit) for income taxes consists of the following:

	Successor	Predecessor		
(In thousands)	July 7, 2007 to February 1, 2008	February 3, 2007 to July 6, 2007	2006	2005
Current:				
Federal	$ (25,726)	$ 31,114	$ 101,919	$ 175,344
Foreign	409	495	1,200	1,205
State	4,306	1,258	17,519	9,694
	(21,011)	32,867	120,638	186,243
Deferred:				
Federal	22,157	(18,750)	(34,807)	8,479
Foreign	-	-	13	17
State	(2,921)	(2,124)	(3,424)	(252)
	19,236	(20,874)	(38,218)	8,244
	$ (1,775)	$ 11,993	$ 82,420	$ 194,487

A reconciliation between actual income taxes and amounts computed by applying the federal statutory rate to income before income taxes is summarized as follows:

	Successor		Predecessor					
(Dollars in thousands)	July 7, 2007 to February 1, 2008		February 3, 2007 to July 6, 2007		2006		2005	
U.S. federal statutory rate on earnings before income taxes	$ (2,308)	35.0%	$ 1,399	35.0%	$ 77,127	35.0%	$ 190,625	35.0%
State income taxes, net of federal income tax benefit	904	(13.7)	(1,135)	(28.4)	5,855	2.7	6,223	1.1
Jobs credits, net of federal income taxes	(3,022)	45.8	(2,227)	(55.7)	(5,008)	(2.3)	(4,503)	(0.8)
Increase (decrease) in valuation allowances	-	-	551	13.8	3,211	1.5	(88)	(0.0)
Income tax related interest expense, net of federal income tax benefit	2,738	(41.5)	(172)	(4.3)	-	-	-	-
Nondeductible transaction costs	-	-	13,501	337.9	-	-	-	-
Other, net	(87)	1.3	76	1.9	1,235	0.5	2,230	0.4
	$ (1,775)	26.9%	$ 11,993	300.2%	$ 82,420	37.4%	$ 194,487	35.7%

The income tax rate for the Successor period ended February 1, 2008 is a benefit of 26.9%. This benefit is less than the expected, U.S. statutory rate of 35% due to the incurrence of state income taxes in several of the group's subsidiaries that file their state income tax returns on a separate entity basis and the election to include, effective February 3, 2007, income tax related interest and penalties in the amount reported as income tax expense.

The income tax rate for the Predecessor period ended July 6, 2007 is an expense of 300.2%. This expense is higher than the expected U.S. statutory rate of 35% due principally to the non-deductibility of certain acquisition related expenses.

The 2006 income tax rate was higher than the 2005 rate by 1.7%. Factors contributing to this increase include additional expense related to the adoption of a new tax system in the State of Texas; a reduction in the contingent income tax reserve due to the resolution of contingent liabilities that is less than the decrease that occurred in 2005; an increase in the deferred tax valuation allowance, and an increase related to a non-recurring benefit recognized in 2005 related to an internal restructuring. Offsetting these rate increases was a reduction in the income tax rate related to federal income tax credits. Due to the reduction in the Company's 2006 income before tax, a small increase in the amount of federal income tax credits earned yielded a much larger percentage reduction in the income tax rate for 2006 versus 2005.

Deferred taxes reflect the effects of temporary differences between carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets and liabilities are as follows:

(In thousands)	Successor February 1, 2008	Predecessor February 2, 2007
Deferred tax assets:		
Deferred compensation expense	$ 6,354	$ 10,090
Accrued expenses and other	4,379	4,037
Accrued rent	5,909	10,487
Accrued insurance	61,887	9,899
Deferred gain on sale/leasebacks	-	2,312
Inventories	-	5,874
Interest rate hedges	30,891	-
Tax benefit of FIN 48 income tax and interest reserves	16,209	-
Other	9,947	4,609
State tax net operating loss carryforwards, net of federal tax	10,342	4,004
State tax credit carryforwards, net of federal tax	8,727	8,604
	154,645	59,916
Less valuation allowances	(1,560)	(5,249)
Total deferred tax assets	153,085	54,667
Deferred tax liabilities:		
Property and equipment	(108,675)	(71,465)
Inventories	(20,291)	-
Trademarks	(428,627)	-
Amortizable assets	(64,419)	-
Other	(501)	(478)
Total deferred tax liabilities	(622,513)	(71,943)
Net deferred tax liabilities	$(469,428)	$ (17,276)

Net deferred tax liabilities are reflected separately on the consolidated balance sheets as current and noncurrent deferred income taxes. The following table summarizes net deferred tax liabilities as recorded in the consolidated balance sheets:

(In thousands)	Successor February 1, 2008	Predecessor February 2, 2007
Current deferred income tax assets, net	$ 17,297	$ 24,321
Noncurrent deferred income tax liabilities, net	(486,725)	(41,597)
Net deferred tax liabilities	$ (469,428)	$ (17,276)

The Company has a federal net operating loss carryforward as of February 1, 2008 of approximately $44.5 million which will expire in 2027. The Company also has state net operating loss carryforwards that total approximately $261.1 million and will expire beginning in 2012 through 2027 and state tax credit carryforwards of approximately $13.4 million that will expire beginning in 2008 through 2027.

The valuation allowance has been provided principally for state tax credit carryforwards. The full amount of the change in the valuation allowance for the 2007 Successor period, a decrease of $4.2 million, was recorded as an adjustment to goodwill. The increase of $0.6 million in the Predecessor period ended July 6, 2007, the increase of $3.2 million in 2006 and the decrease of $0.1 million in 2005 were included in income tax expense for the respective periods. Based upon expected future income and available tax planning strategies, management believes that it is more likely than not that the results of operations will generate sufficient taxable income

79

to realize the deferred tax assets after giving consideration to the valuation allowance. After the Merger, the full benefit of any reversal of the valuation allowance will reduce goodwill and not income tax expense.

The Predecessor 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.

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 Predecessor period ended July 6, 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. None of the Company’s federal income tax returns are currently under examination by the Internal Revenue Service; however, fiscal years 2004 and later are still subject to possible 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 February 1, 2008, the total reserves for uncertain tax benefits, interest expense related to income taxes and potential income tax penalties were $96.6 million, $19.7 million and $1.5 million, respectively, for a total of $117.8 million. Of this amount, $23.2 million and $78.3 are reflected in current liabilities as accrued expenses and other and in other noncurrent liabilities, respectively, in the consolidated balance sheet with the remaining $16.3 million reducing deferred tax assets related to net operating loss carry forwards.

The change, from the date of adoption, through the end of the Predecessor period ended July 6, 2007 in the reserves for uncertain tax benefits, interest expense related to income taxes and potential income tax penalties that impacted the consolidated statement of operations was a net increase of $10.4 million and $0.2 million and a decrease of $0.4 million, respectively. The change, from the end of the Predecessor period ended July 6, 2007, through the end of the Successor period ended February 1, 2008, in the reserves for uncertain tax benefits and interest expense related to income taxes that impacted the consolidated statement of operations was a net increase of $0.2 million and $4.2 million, respectively. There was no change in the reserve for potential income tax penalties during the Successor period.

The Company believes that it is reasonably possible that the reserve for uncertain tax positions may be reduced by approximately $64.8 million in the coming twelve months as a result of the settlement of currently ongoing state income tax examinations and the anticipated filing of an income tax accounting method change request that is expected to resolve certain uncertainties related to accounting methods employed by the Company. The reasonably possible change of $64.8 million is included in both current liabilities ($21.2 million) and other noncurrent liabilities ($43.6 million) in the consolidated balance sheet as of February 1, 2008. Also, as of February 1, 2008 (after the merger and the related application of purchase accounting), approximately $0.3 million of the reserve for uncertain tax positions would impact the Company's effective income tax rate if the Company were to recognize the tax benefit for these positions.

A reconciliation of the reserve associated with uncertain income tax positions from February 3, 2007 (the date of adoption) through February 1, 2008 is as follows:

(In thousands)		
Balance as of February 3, 2007	$	77,864
Increases – tax positions taken in the current year		19,568
Increases – tax positions taken in prior years		1,149
Decrease – tax positions taken in prior years		(9)
Statute expirations		(185)
Settlements		(1,787)
Balance as of February 1, 2008	$	96,600

6. Current and long-term obligations

Current and long-term obligations consist of the following:

(In thousands)	Successor February 1, 2008	Predecessor February 2, 2007
Senior secured term loan facility	$ 2,300,000	$ -
Senior secured asset-based revolving credit facility	102,500	-
10 5/8% Senior Notes due July 15, 2015, net of discount of $22,083	1,152,917	-
11 7/8/12 5/8% Senior Subordinated Notes due July 15, 2017	700,000	-
8 5/8% Notes due June 15, 2010, net of discount of $- and $146, respectively	1,822	199,832
Capital lease obligations	10,268	55,711
Tax increment financing due February 1, 2035	14,495	14,495
	4,282,002	270,038
Less: current portion	(3,246)	(8,080)
Long-term portion	$ 4,278,756	$ 261,958

On July 6, 2007, the Company entered into two senior secured credit agreements (the "New Credit Facilities"). The New Credit Facilities provide financing of $3,425.0 million, consisting of $2,300.0 million in a senior secured term loan facility which matures on July 6, 2014, and a senior secured asset-based revolving credit facility of up to $1,125.0 million, subject to borrowing base availability, which matures on July 6, 2013.

Under the New Credit Facilities, the Company has the right at any time to request up to $325.0 million of incremental commitments under one or more incremental term loan facilities and/or asset-based revolving credit facilities, subject to certain conditions and subject to the lender's desire to extend the incremental facilities.

The amount from time to time available under the senior secured asset-based revolving credit facility (including in respect of letters of credit) may not exceed the borrowing base (consisting of specified percentages of eligible inventory and credit card receivables less any applicable availability reserves). The senior secured asset-based revolving credit facility includes a $1.0 billion tranche and a $125.0 million ("last out") tranche. Repayments of the senior secured asset-based revolving credit facility will be applied to the $125.0 million tranche only after all other tranches have been fully paid down. As of February 1, 2008, the Company had borrowed $102.5 million under the "last out" tranche.

Borrowings under the New Credit Facilities bear interest at a rate equal to an applicable margin plus, at the Company's option, either (a) LIBOR or (b) a base rate (which is usually equal to the prime rate). The applicable margin for borrowings is (i) under the term loan facility, 2.75% with respect to LIBOR borrowings and 1.75% with respect to base-rate borrowings and (ii) as of February 1, 2008, under the asset-based revolving credit facility (except in the last out tranche described above), 1.50% with respect to LIBOR borrowings and 0.50% with respect to base-rate borrowings and for any last out borrowings, 2.25% with respect to LIBOR borrowings and 1.25% with respect to base-rate borrowings. The applicable margins for borrowings under the asset-based revolving credit facility (except in the case of last out borrowings) are subject to adjustment each quarter based on average daily excess availability under the asset-based revolving credit facility. As of February 1, 2008, the average interest rate for borrowings under the revolving credit facility was 6.35%. The interest rate for borrowings under the term loan facility was 6.22% (without giving effect to the interest rate swap discussed in Note 1) as of February 1, 2008.

In addition to paying interest on outstanding principal under the New Credit Facilities, the Company is required to pay a commitment fee to the lenders under the asset-based revolving credit facility in respect of the unutilized commitments thereunder. The commitment fee rate was 0.375% per annum. The commitment fee rate will be reduced (except with regard to the last out tranche) to 0.25% per annum at any time that the unutilized commitments under the asset-based credit facility are equal to or less than 50% of the aggregate commitments under the asset-based revolving credit facility. The Company also must pay customary letter of credit fees.

The senior secured credit agreement for the term loan facility requires the Company to prepay outstanding term loans, subject to certain exceptions, with percentages of excess cash flow, proceeds of non-ordinary course asset sales or dispositions of property, and proceeds of incurrences of certain debt. In addition, the senior secured credit agreement for the asset-based revolving credit facility requires the Company to prepay the asset-based revolving credit facility, subject to certain exceptions, with proceeds of non-ordinary course asset sales or dispositions of property and any borrowings in excess of the then current borrowing base. Beginning September 30, 2009, the Company is required to repay installments on the loans under the term loan credit facility in equal quarterly principal amounts in an aggregate amount per annum equal to 1% of the total funded principal amount at July 6, 2007, with the balance payable on July 6, 2014.

All obligations under the New Credit Facilities are unconditionally guaranteed by substantially all of the Company's existing and future domestic subsidiaries (excluding certain immaterial subsidiaries and certain subsidiaries designated by the Company under the New Credit Facilities as "unrestricted subsidiaries").

All obligations and guarantees of those obligations under the term loan credit facility are secured by, subject to certain exceptions, a second-priority security interest in all existing and after-acquired inventory and accounts receivable; a first priority security interest in substantially all of the Company's and the guarantors' tangible and intangible assets (other than the inventory and accounts receivable collateral just described); and first-priority pledge of the capital stock held by the Company. All obligations under the asset-based revolving credit facility are secured by all existing and after-acquire inventory and accounts receivable, subject to certain exceptions.

The New Credit Facilities contain certain covenants, including, among other things, covenants that limit the Company's ability to incur additional indebtedness, sell assets, incur additional liens, pay dividends, make investments or acquisitions, or repay certain indebtedness.

As of February 1, 2008, the Company had $102.5 million in borrowings, $28.8 million of commercial letters of credit, and $69.2 million of standby letters of credit outstanding under the asset-based revolving credit facility, with excess availability under that facility of $769.2 million. As of February 1, 2008, the Company had $2,300.0 million outstanding under the term loan facility.

In addition, on July 6, 2007, in conjunction with the Merger, the Company issued $1,175.0 million aggregate principal amount of 10.625% senior notes due 2015 (the "senior notes") which were issued net of a discount of $23.2 million and which mature on July 15, 2015 pursuant to an indenture, dated as of July 6, 2007 (the "senior indenture"), and $725 million aggregate principal amount of 11.875%/12.625% senior subordinated toggle notes due 2017 (the "senior subordinated notes"), which mature on July 15, 2017, pursuant to an indenture, dated as of July 6, 2007 (the "senior subordinated indenture"). The senior notes and the senior subordinated notes are collectively referred to herein as the "notes". The senior indenture and the senior subordinated indenture are collectively referred to herein as the "indentures".

Interest on the notes is payable on January 15 and July 15 of each year, commencing on January 15, 2008. Interest on the senior notes will be payable in cash. Cash interested on the senior subordinated notes will accrue at a rate of 11.875% per annum and PIK interest (as that term is defined below) will accrue at a rate of 12.625% per annum. The initial interest payment on the senior subordinated notes was paid in cash. For certain subsequent interest periods, the Company may elect to pay interest on the senior subordinated notes by increasing the principal amount of the senior subordinated notes or issuing new senior subordinated notes ("PIK interest").

The notes are fully and unconditionally guaranteed by each of the existing and future direct or indirect wholly owned domestic subsidiaries that guarantee the obligations under the Company's New Credit Facilities.

The Company may redeem some or all of the notes at any time at redemption prices described or set forth in the indentures. During the fourth quarter of fiscal 2007, we repurchased $25.0 million of the 11.875%/12.625% senior subordinated toggle notes due 2017, resulting in a pretax gain of $4.9 million.

The indentures contain certain covenants, including, among other things, covenants that limit the Company's ability to incur additional indebtedness, create liens, sell assets, enter into transactions with affiliates, or consolidate or dispose of all of its assets.

Scheduled debt maturities for the Company's fiscal years listed below are as follows (in thousands): 2008 - $3,246; 2009 - $13,009; 2010 - $25,171; 2011 - $23,254; 2012 - $23,272; thereafter - $4,216,034.

On July 6, 2007, immediately after the completion of the Merger, the Company completed a cash tender offer to purchase any and all of its $200 million principal amount of 8 5/8% Notes due June 2010 (the "2010 Notes"). Approximately 99% of the 2010 Notes were validly tendered and accepted for payment. The tender offer included a consent payment equal to 3% of the par value of the 2010 Notes, and such payments along with associated settlement costs totaling $6.2 million were paid and reflected as a loss on debt retirement in the 2007 Successor period presented. Additionally, because the Company received the requisite consents to the proposed amendments to the indenture pursuant to which the 2010 Notes were issued, a supplemental indenture to effect such amendments was executed and delivered. The amendments, which eliminated substantially all of the restrictive covenants contained in the indenture, became operative upon the purchase of the tendered 2010 Notes.

7. Commitments and contingencies

Leases

As of February 1, 2008, the Company was committed under capital and operating lease agreements and financing obligations for most of its retail stores, three of its DCs, and certain of its furniture, fixtures and equipment. The majority of the Company's stores are subject to short-term leases (an average of three to five years) with multiple renewal options when available. The Company also has stores subject to build-to-suit arrangements with landlords, which typically carry a primary lease term of 10 years with multiple renewal options. Approximately 44% of the stores have provisions for contingent rentals based upon a percentage of defined sales volume. Certain leases contain restrictive covenants. As of February 1, 2008, the Company is not aware of any material violations of such covenants, however, there is a degree of uncertainty with regard to the Company's DC leases as discussed below.

The Merger and certain of the related financing transactions may be interpreted as giving rise to certain trigger events (which may include events of default) under the Company's three DC leases. In such event, the Company's net cost of acquiring the underlying assets could approximate $112 million. At this time, the Company does not believe the resolution of such issues would result in the purchase of these DCs; however, the payments associated with such an outcome would have a negative impact on the Company's liquidity. To minimize the uncertainty associated with such possible interpretations, the Company is negotiating the restructuring of these leases and the related underlying debt. The Company has concluded that a probable loss exists in connection with the restructurings and has recorded expenses totaling $12.0 million in SG&A expenses in the Successor statement of operations for the period ended February 1, 2008. The ultimate resolution of these negotiations may result in changes in the amounts of such losses, and such changes may be material.

In January 1999 and April 1997, the Company sold its DCs located in Ardmore, Oklahoma and South Boston, Virginia, respectively, for 100% cash consideration. Concurrent with the sale transactions, the Company leased the properties back for periods of 23 and 25 years, respectively. The transactions were recorded as financing obligations rather than sales as a result of, among other things, the lessor's ability to put the properties back to the Company under certain circumstances. The property and equipment, along with the related lease obligations, associated with these transactions were recorded in the consolidated balance sheets.

In August 2007, the Company purchased a secured promissory note (the "Ardmore Note") from Principal Life Insurance Company, which had a face value of $34.3 million at the date of purchase and approximated the remaining financing obligation. The Ardmore Note represents debt issued by the third party entity from which the Company leases the Ardmore DC. The Ardmore Note is being accounted for as a "held to maturity" debt security in accordance with the provisions of SFAS 115, "Accounting for Certain Investments in Debt and Equity Securities" (see Note 1). However, by acquiring the Ardmore Note, the Company holds the debt instrument pertaining to its lease financing obligation and, because a legal right of offset exists, is accounting for the acquired Ardmore Note as a reduction of its outstanding financing obligations in its consolidated balance sheet as of February 1, 2008 in accordance with the provisions of FASB Interpretation 39, "Offsetting of Amounts Related to Certain Contracts – An Interpretation of APB Opinion 10 and FASB Statement 105."

In May 2003, the Company purchased two secured promissory notes (the "South Boston Notes") from Principal Life Insurance Company totaling $49.6 million. The South Boston Notes represented debt issued by the third party entity from which the Company leased the South Boston DC. In June 2006, the Company acquired the third party entity, which owned legal title to the South Boston DC assets and had issued the related debt in connection with the original financing transaction. There was no material gain or loss recognized as a result of this transaction. Based on the Company's ownership of the third party entity at February 1, 2008, the financing obligation and South Boston Notes are eliminated in the Company's consolidated financial statements.

Future minimum payments as of February 1, 2008 for capital and operating leases are as follows:

(In thousands)	Capital Leases	Operating Leases
2008	$ 3,740	$ 335,457
2009	1,909	286,490
2010	810	237,873
2011	599	198,954
2012	599	158,464
Thereafter	6,476	396,977
Total minimum payments	14,133	$ 1,614,215
Less: imputed interest	(3,865)	
Present value of net minimum lease payments	10,268	
Less: current portion, net	(3,246)	
Long-term portion	$ 7,022	

Capital leases were discounted at an effective interest rate of approximately 5.43% at February 1, 2008. The gross amount of property and equipment recorded under capital leases and financing obligations at February 1, 2008 and February 2, 2007, was $33.5 million and $85.1 million, respectively. Accumulated depreciation on property and equipment under capital leases and financing obligations at February 1, 2008 and February 2, 2007, was $2.7 million and $41.0 million, respectively.

Rent expense under all operating leases is as follows:

	Successor	Predecessor		
(In thousands)	July 7, 2007 through February 1, 2008	February 3, 2007 through July 6, 2007	2006	2005
Minimum rentals (a)	$ 205,672	$ 143,188	$ 327,911	$ 295,061
Contingent rentals	8,780	6,964	16,029	17,245
	$ 214,452	$ 150,152	$ 343,940	$ 312,306

(a) Excludes net contract termination costs of $2.4 million, $19.1 million, and $5.7 million for the Successor period ended February 1, 2008 and the Predecessor periods ended July 6, 2007 and February 2, 2007, respectively. These expenses were recorded in association with the closing of stores associated with strategic initiatives as further discussed in Note 3. Also excludes amortization of leasehold interests of $26.1 million included in rent expense for the Successor period ended February 1, 2008.

Legal proceedings

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) (“Richter”) 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. The number of persons who will be included in the class has not been determined, and the court has not approved 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, to evaluate, among other things, certain appeals currently pending in the Eleventh Circuit involving claims similar to those raised in this action. That stay has been extended through June 30, 2008. During the 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. If the court ultimately permits Notice to issue, the Company will have an opportunity at the close of the discovery period 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 this action is not appropriate for collective action treatment. The Company intends to vigorously defend this action. However, at this time, it is not possible to predict whether the court ultimately will permit this action to proceed collectively, and no assurances can be given that the Company will be successful in the defense on the merits or otherwise. If the Company is not successful in its efforts to defend this action, the resolution 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 No. 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, 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 that the Company's 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 the defense on the merits or otherwise, and, if it is not successful, 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"). The complaint subsequently was amended to include additional plaintiffs, who also allege to have been paid less than males because of their sex, and to add allegations that the Company's compensation practices disparately impacted females. Under the amended complaint, Plaintiffs seek to proceed collectively under the Equal Pay Act and as a class under Title VII, and request back wages, injunctive and declaratory relief, liquidated damages, punitive damages and attorney's fees and costs.

On July 9, 2007, the plaintiffs filed a motion in which they asked the court to approve the issuance of notice to a class of current and former female store managers under the Equal Pay Act. The Company opposed plaintiffs' motion. On November 30, 2007, the court conditionally certified a nationwide class of females under the Equal Pay Act who worked for Dollar General as store managers between November 30, 2004 and November 30, 2007. The notice was issued on January 11, 2008, and persons to whom the notice was sent were required to opt into the suit by March 11, 2008. The Company will have an opportunity at the close of the discovery period to seek decertification of the Equal Pay Act class, and the Company expects to file such motion.

At this time, it is not possible to predict whether the court ultimately will permit the Calvert action to proceed collectively under the Equal Pay Act or as a class under the Title VII. However, the Company believes that the case is not appropriate for class or collective treatment and 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 the 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 November 9, 2007, the Company was served with an action entitled Sheneica Nunn, et al. v. Dollar General Corporation, et al. (Circuit Court for Dane County, Wisconsin, Case No. 07CV4178) in which the plaintiff, on behalf of herself and a putative class of African-American applicants, alleges that the Company's criminal background check process disparately impacts African-Americans in violation of Title VII of the Civil Rights Act of 1964, as amended, and the Wisconsin Fair Employment Act. The Company has removed the case to federal court, and it currently is pending in the United States District Court for the Western District of Wisconsin. At this time, it is not possible to predict whether the court will permit this action to proceed as a class under either Title VII or the Wisconsin statute. However, the Company believes that this action is not appropriate for class treatment and that the Company's background check 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 the defense on the merits or otherwise, and, if it is not successful, the resolution of this action 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, the Company and the EPA agreed on January 17, 2008 to resolve this matter through the Company's payment of a $155,826 penalty.

The Company paid this penalty in the fourth quarter of fiscal 2007 and has received full reimbursement from the product vendor.

Subsequent to the announcement of the agreement relating to the Merger, the Company and its directors were named in seven putative class actions alleging claims for breach of fiduciary duty arising out of the Company's proposed sale to KKR. Each of the complaints alleged, among other things, that the Company's directors engaged in "self-dealing" by agreeing to recommend the transaction to the Company's shareholders and that the consideration available to such shareholders in the 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. By order dated April 26, 2007, the seven lawsuits were consolidated in the court under the caption, "In re: Dollar General," Case No. 07MD-1. On June 13, 2007, the court denied the Plaintiffs' motion for a temporary injunction to block the shareholder vote that was then held on June 21, 2007. On June 22, 2007, the Plaintiffs filed their amended complaint making claims substantially similar to those outlined above. The matter is currently in discovery. The Company believes that the foregoing lawsuit is without merit and continues to defend the action vigorously; however, if the Company is not successful in that defense, its resolution could have a material adverse effect on the Company's financial statements as a whole.

From time to time, the Company is a party to various other legal actions involving claims incidental to the conduct of its business, including actions by employees, consumers, suppliers, government agencies, or others through private actions, class actions, administrative proceedings, regulatory actions or other litigation, including under federal and state employment laws and wage and hour laws. 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 adverse 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 results of operations or financial position. In addition, certain of these lawsuits, if decided adversely to the Company or settled by the Company, may result in liability material to the Company's financial position or may negatively affect our operating results if changes to the Company's business operation are required.

8. Benefit plans

The Dollar General Corporation 401(k) Savings and Retirement Plan, which became effective on January 1, 1998, is a safe harbor defined contribution plan and is subject to the Employee Retirement and Income Security Act ("ERISA").

Participants are permitted to contribute between 1% and 25% of their pre-tax annual eligible compensation as defined in the 401(k) plan document, subject to certain limitations under the Internal Revenue Code. Employees who are over age 50 are permitted to contribute additional amounts on a pre-tax basis under the catch-up provision of the 401(k) plan subject to Internal Revenue Code limitations. The Company currently matches employee contributions, including catch-up contributions, at a rate of 100% of employee contributions, up to 5% of annual eligible salary, after an employee has been employed for one year and has completed a minimum of 1,000 hours of service.

A participant's right to claim a distribution of his or her account balance is dependent on ERISA guidelines and Internal Revenue Service regulations. All active employees are fully vested in all contributions to the 401(k) plan. During the 2007 Successor and Predecessor periods, 2006 and 2005, the Company expensed approximately $3.0 million, $4.3 million, $6.4 million, and $5.8 million, respectively, for matching contributions. The Merger did not significantly impact the comparability of such expense amounts between periods.

The Company also has a nonqualified supplemental retirement plan and compensation deferral plan (called the Dollar General Corporation CDP/SERP Plan) for a select group of management and highly compensated employees. The supplemental retirement plan is a noncontributory defined contribution plan with annual Company contributions ranging from 2% to 12% of base pay plus bonus depending upon age plus years of service and job grade. Under the compensation deferral plan, participants may defer up to 65% of base pay and up to 100% of bonus pay. An employee may be designated for participation in one or both of the plans, according to the eligibility requirements of the plans. The Company matches base pay deferrals at a rate of 100% of base pay deferral, up to 5% of annual salary, with annual salary offset by the amount of match-eligible salary in the 401(k) plan. All participants are 100% vested in their compensation deferral plan accounts.

As a result of the Merger which constituted a "change in control" under the CDP/SERP Plan, all previously unvested amounts under the supplemental retirement plan vested on July 6, 2007. For newly eligible SERP participants after July 6, 2007, the supplemental retirement plan accounts vest at the earlier of the participant's attainment of age 50 or the participant's being credited with 10 or more "years of service", upon termination of employment due to death or "total and permanent disability" or upon a "change in control", all as defined in the CDP/SERP Plan. The Company incurred compensation expense for these plans of approximately $0.3 million in the 2007 Successor period, $0.5 million in the 2007 Predecessor period, $0.8 million in 2006 and $0.6 million in 2005.

The supplemental retirement plan and compensation deferral plan assets are invested at the option of the participant in an account that mirrors the performance of a fund or funds selected by the Company's Compensation Committee or its delegate (the "Mutual Fund Options") or, prior to the Merger, in an account that mirrored the performance of the Company's common stock (the "Common Stock Option"). A participant's compensation deferral plan and supplemental retirement plan account balances will be paid in accordance with the participant's election by (a) lump sum, (b) monthly installments over a 5, 10 or 15 year period or (c) a combination of lump sum and installments. The vested amount will be payable at the time designated by the plan upon the participant's termination of employment or retirement, except that participants may elect to receive an in-service distribution or an "unforeseeable emergency hardship" distribution of vested amounts credited to the compensation deferral account. Account balances deemed to be invested in the Mutual Fund Options are payable in cash and, prior to the Merger, account balances deemed to be invested in the Common Stock Option were payable in shares of Dollar General common stock and cash in lieu of fractional shares.

As a result of the Merger, the CDP/SERP Plan liabilities were fully funded into an irrevocable rabbi trust. All account balances deemed to be invested in the Common Stock Option were liquidated at a value of $22.00 per share and the proceeds were transferred to an existing Mutual Fund Option within the Plan.

Asset balances in the Mutual Funds Option are stated at fair market value, which is based on quoted market prices. The current portion of these balances is included in Prepaid expenses and other current assets and the long term portion is included in Other assets, net in the consolidated balance sheets. In accordance with EITF 97-14 “Accounting for Deferred Compensation Arrangements Where Amounts Earned Are Held in a Rabbi Trust and Invested,” the Company’s stock was recorded at historical cost and included in Other shareholders’ equity, prior to the Merger. Also, prior to the Merger, the deferred compensation liability related to the Company stock for active plan participants was included in shareholders’ equity and subsequent changes to the fair value of the obligation were not recognized, in accordance with the provisions of EITF 97-14. However, as a result of the Merger, Plan participants no longer have the option of investing in the Company’s stock. The deferred compensation liability related to the Mutual Funds Option is recorded at the fair value of the investments held in the trust. The current portion of these balances is included in Accrued expenses and other and the long term portion is included in Other liabilities in the consolidated balance sheets.

The Company sponsored through 2007 a supplemental executive retirement plan for the Chief Executive Officer (called the Supplemental Executive Retirement Plan for David A. Perdue) and accounted for the plan in accordance with SFAS 158. As a result of the Merger, which constituted a change in control under the terms of this plan and the grantor trust agreement, and Mr. Perdue’s subsequent resignation, Mr. Perdue became 100% vested. A deposit of $6,208,966 was made to the trust representing Mr. Perdue’s lump sum vested benefit and accumulated interest, which amount was paid to Mr. Perdue on January 7, 2008 effectively terminating the plan.

Prior to the Merger, non-employee directors could defer all or a part of any fees normally paid by the Company to a voluntary nonqualified compensation deferral plan. The compensation eligible for deferral includes the annual retainer, meeting and other fees, as well as any per diem compensation for special assignments, earned by a director for his or her service to the Company’s Board of Directors or one of its committees. The deferred compensation was credited to a liability account, which was then invested at the option of the director, in deemed investments which mirrored either the Mutual Fund Options or the Common Stock Option and the deferred compensation was to be paid in accordance with the director’s election. All deferred compensation was immediately due and payable upon a “change in control” of the Company, as defined by the Plan. As a result of the Merger, which constituted a change in control under the Plan, all accounts held in the Deferred Compensation Plan for Non-Employee Directors were distributed.

9. Share-based payments

The Company accounts for share-based payments in accordance with SFAS 123(R). Under SFAS 123(R), the fair value of each award is separately estimated and amortized into compensation expense over the service period. The fair value of the Company's stock option grants are estimated on the grant date using the Black-Scholes-Merton valuation model. The application of this valuation model involves assumptions that are judgmental and highly sensitive in the determination of compensation expense.

The Successor statement of operations for the period from July 7, 2007 to February 1, 2008 reflect share-based compensation expense (a component of SG&A expenses) under the fair value method of SFAS 123(R) for outstanding share-based awards and a corresponding reduction of pre-tax income in the amount of $3.8 million ($2.4 million net of tax).

The Company recognized $45.4 million of share-based compensation expense in the Predecessor statements of operations in 2007 ($28.5 million net of tax), including $6.0 million of compensation expense prior to the Merger included in SG&A expenses comprised of $2.3 million and $3.7 million, respectively, for stock options and restricted stock and restricted stock units. The remaining $39.4 million of such expense related directly to the Merger is reflected in Transaction and related costs in the consolidated statement of operations for the Predecessor period ended July 6, 2007, consisting of $18.7 million and $20.7 million, respectively, for the accelerated vesting of stock options and restricted stock and restricted stock units.

For the year ended February 2, 2007, the fair value method of SFAS 123(R) resulted in additional share-based compensation expense and a corresponding reduction in net income before income taxes in the amount of $3.6 million ($2.2 million net of tax).

Prior to the Merger, the Company maintained various share-based compensation programs which included options, restricted stock and restricted stock units. In connection with the Merger, the Company's outstanding stock options, restricted stock and restricted stock units became fully vested immediately prior to the closing of the Merger and were settled in cash, canceled or, in limited circumstances, exchanged for new options of the Company, as described below. Unless exchanged for new options, each option holder received an amount in cash, without interest and less applicable withholding taxes, equal to $22.00 less the exercise price of each in-the-money option. Additionally, each restricted stock and restricted stock unit holder received $22.00 in cash, without interest and less applicable withholding taxes. Certain stock options held by Company management were exchanged for new options to purchase common stock in the Company (the "Rollover Options"). The exercise price of the Rollover Options and the number of shares of Company common stock underlying the Rollover Options were adjusted as a result of the Merger. The Rollover Options otherwise continue under the terms of the equity plan under which the original options were issued.

On February 3, 2006, the vesting of all outstanding options granted prior to August 2, 2005, other than options previously granted to the Company's then CEO and options granted in 2005 to the officers of the Company at the level of Executive Vice President or above, accelerated pursuant to a January 24, 2006 action of the Compensation Committee of the Company's Board of Directors. In addition, pursuant to that Compensation Committee action, the vesting of all outstanding options granted on or after August 2, 2005 but prior to January 24, 2006, other than options granted during that time period to the officers of the Company at the level of Executive Vice President or above, accelerated effective as of the date that is six months after the applicable grant date. Certain options granted on January 24, 2006 to certain newly hired officers below the level of Executive Vice President were granted with a six-month vesting period. The decision to accelerate the vesting of these stock options resulted in compensation expense of $0.9 million, before income taxes, recognized during the fourth quarter of 2005, and was made primarily to reduce non-cash compensation expense to be recorded in future periods under the provisions of SFAS 123(R). The future expense eliminated as a result of the decision to accelerate the vesting of these options was approximately $28 million, or $17 million net of income taxes, over the four-year period during which the stock options would have vested, subject to the impact of additional adjustments related to certain stock option forfeitures. The Company also believed this decision benefited employees.

On July 6, 2007, the Company's Board of Directors adopted the 2007 Stock Incentive Plan for Key Employees (the "Plan"). The Plan provides for the granting of stock options, stock appreciation rights, and other stock-based awards or dividend equivalent rights to key employees, directors, consultants or other persons having a service relationship with the Company, its subsidiaries and certain of its affiliates. The number of shares of Company common stock authorized for grant under the Plan is 24,000,000. As of February 1, 2008, 3,470,200 of such shares are available for future grants.

During the Successor period ended February 1, 2008, the Company granted options that vest solely upon the continued employment of the recipient ("Time Options") as well as options that vest upon the achievement of predetermined annual or cumulative financial-based targets that coincide with the Company's fiscal year ("Performance Options"). According to the award terms, 20% of the Time Options vest on each of the five successive anniversary dates of the merger transaction, and 20% of the Performance Options vests at the end of each of the successive five fiscal years in which the performance target is achieved. In the event the performance target is not achieved in any given year, such options for that year will subsequently vest upon the achievement of a cumulative performance target. Vesting of the Time Options and Performance Options is also subject to acceleration in the event of an earlier change in control or public offering. Each of these options, whether Time Options or Performance Options have a contractual term of 10 years and an exercise price equal to the fair value of the stock on the date of grant.

Both the Time Options and the Performance Options are subject to various provisions by which the Company may require the employee, upon termination, to sell to the Company any vested options or shares received upon exercise of the Time Options or Performance Options at amounts that differ based upon the reason for the termination. In particular, in the event that the employee resigns "without good reason" (as defined in the management stockholders agreement), then any options whether or not then exercisable are forfeited and any shares received upon prior exercise of such options are callable at the Company's option at an amount equal to the lesser of fair value or the amount paid for the shares (i.e. the exercise price). In such cases, because the employee would not benefit in any share appreciation over the exercise price, for accounting purposes, under SFAS 123(R) such options are not considered vested until the expiration of the Company's call option (July 6, 2012). Accordingly, all references to the vesting provisions or vested status of the options discussed in this note give effect to the vesting pursuant to the provisions of SFAS 123(R) and may differ from descriptions of the vesting status of the Time Options and Performance Options located elsewhere in the Company's Annual Report on Form 10-K.

Each of the Company's management-owned shares, Rollover Options, and vested new options include certain provisions by which the holder of such shares, Rollover Options, or vested new options may require the Company to repurchase such instruments in limited circumstances. Specifically, each such instrument is subject to a repurchase right for a period of 365 days after termination due to the death or disability of the holder of the instrument that occurs within five years from the closing date of the Merger. In such circumstances, the holder of such instruments may require the Company to repurchase any shares at the fair market value of such shares and any Rollover Options or vested new options at a price equal to the intrinsic value of such rollover or vested new options. Because the Company does not have control over the circumstances in which it may be required to repurchase the outstanding shares or Rollover Options, such shares and Rollover Options, valued at a fair value and intrinsic value of $6.0 million and $3.2 million, respectively, have been classified as Redeemable common stock in the accompanying consolidated balance sheet at February 1, 2008. Because redemption of such shares is uncertain, such shares are not subject to re-measurement until their redemption becomes probable.

In addition to the repurchase rights upon death or disability that are common to all management held shares, Rollover Options, and vested new options, the management stockholder's agreement which the Company entered into with certain executive officers provides such officers with an additional repurchase right in the event their employment terminates for any reason prior to July 21, 2008. Such executive officers may require the Company to repurchase their outstanding shares and Rollover Options at a price of $5 per share in the case of shares and the difference in $5 per share and the exercise price of any Rollover Options that they hold. This repurchase right exists for a period of 365 days following their termination within the required timeframe. As noted above, each of the shares, whether held by general members of management or executive officers, has been classified within Redeemable common stock on the accompanying consolidated balance sheet as of February 1, 2008. In the case of the Rollover Options held by the executive officers, however, the additional repurchase rights in the event of their termination prior to July 21, 2008 are considered within the control of the employee, and as such, $3.6 million (representing the fixed repurchase price) related to such Rollover Options have been classified in Other (noncurrent) liabilities in the accompanying consolidated balance sheet at February 1, 2008 pursuant to SFAS 123(R).

The Company adopted SFAS 123(R) effective February 4, 2006 and began recognizing compensation expense for stock options based on the fair value of the awards on the grant date. The Company adopted SFAS 123(R) under the modified-prospective-transition method and, therefore, results from prior periods have not been restated. The following table illustrates the effect on net income and earnings per share as if the Company had applied the fair value recognition provisions of SFAS 123 to options granted under the Company's stock plans for the year ended February 3, 2006. For purposes of this pro forma disclosure, the value of the options is estimated using the Black-Scholes-Merton option pricing model for all option grants.

(In thousands)		Year Ended February 3, 2006
Net income – as reported	$	350,155
Deduct: Total pro forma stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects per SFAS 123		32,621
Net income – pro forma	$	317,534

Under SFAS 123(R), forfeitures are estimated at the time of valuation and reduce expense ratably over the vesting period. Under SFAS 123, the Company elected to account for forfeitures when awards were actually forfeited, at which time all previous pro forma expense (which, after-tax, approximated $5.5 million in the year ended February 3, 2006) was reversed to reduce pro forma expense for that year.

SFAS 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required prior to the adoption of SFAS 123(R). For the Predecessor period ended July 6, 2007 and year ended February 2, 2007, the $3.9 million and $2.5 million excess tax benefits, respectively, classified as financing cash inflows would have been classified as an operating cash inflow if the Company had not adopted SFAS 123(R). The impact of the adoption of SFAS 123(R) on future results will depend on, among other things, levels of share-based payments granted in the future, actual forfeiture rates and the timing of option exercises.

The fair value of each option grant is separately estimated by applying the Black-Scholes-Merton option pricing valuation model. The weighted average for key assumptions used in determining the fair value of options granted in the Successor period ended February 1, 2008 and Predecessor period ended July 6, 2007 and years ended February 2, 2007 and February 3, 2006, and a summary of the methodology applied to develop each assumption, are as follows:

	February 1, 2008	July 6, 2007	February 2, 2007	February 3, 2006
Expected dividend yield	0%	0.91%	0.82 %	0.85 %
Expected stock price volatility	41.9%	18.5%	28.8 %	27.1 %
Weighted average risk-free interest rate	4.6%	4.5%	4.7 %	4.2 %
Expected term of options (years)	7.5	5.7	5.7	5.0

Expected dividend yield - This is an estimate of the expected dividend yield on the Company's stock. Prior to the Merger this estimate was based on historical dividend payment trends. Subsequent to the Merger, the Company is subject to limitations on the payment of dividends under its credit facilities as further discussed in Note 6. An increase in the dividend yield will decrease compensation expense.

Expected stock price volatility - This is a measure of the amount by which the price of the Company's common stock has fluctuated or is expected to fluctuate. Prior to the Merger, the Company used actual historical changes in the market price of the Company's common stock and implied volatility based upon traded options, weighted equally, to calculate the volatility assumption, as it was the Company's belief that this methodology provided the best indicator of future volatility. For historical volatility, the Company calculated daily market price changes from the date of grant over a past period representative of the expected life of the options to determine volatility. Subsequent to the Merger the expected volatilities have been based upon the historical volatilities of a peer group of four companies, as the Company's common stock is not publicly traded. An increase in the expected volatility will increase compensation expense.

Weighted average risk-free interest rate - This is the U.S. Treasury rate for the week of the grant having a term approximating the expected life of the option. An increase in the risk-free interest rate will increase compensation expense.

Expected term of options - This is the period of time over which the options granted are expected to remain outstanding. For options issued prior to the Merger, the Company took into consideration that its stock option grants prior to August 2002 were significantly different than grants issued on and after that date, and therefore that the historical and post-vesting employee behavior patterns for grants prior to that date were of little or no value in determining future expectations. As a result, the Company excluded these pre-August 2002 grants from its analysis of expected term. For pre-Merger options, the Company estimated expected term using a computation based on an assumption that outstanding options would be exercised approximately halfway through their contractual term, taking into consideration such factors as grant date, expiration date, weighted-average time-to-vest, actual exercises and post-vesting cancellations. Options granted have a maximum term of 10 years. Due to the absence of historical data for grants issued subsequent to the Merger, the Company has estimated the expected term as the mid-point between the vesting date and the contractual term of the option. An increase in the expected term will increase compensation expense.

All nonvested restricted stock and restricted stock unit awards granted for the Predecessor and Successor periods in the year ended February 1, 2008 had a purchase price of zero. The Company records compensation expense on a straight-line basis over the restriction period based on the market price of the underlying stock on the date of grant. The nonvested restricted stock and restricted stock unit awards granted under the plan to employees during the Predecessor period ended July 6, 2007 were originally scheduled to vest and become payable ratably over a three-year period from the respective grant dates. The nonvested restricted stock unit awards granted under the plan to non-employee directors during the Predecessor period ended July 6, 2007 were originally scheduled to vest over a one-year period from the respective grant dates, but became payable as a result of the Merger as discussed above.

In accordance with the provisions of SFAS 123(R), unearned compensation is not recorded within shareholders' equity for nonvested restricted stock and restricted stock unit awards. Accordingly, during the year ended February 2, 2007, the Company reversed its unearned compensation balance as of February 3, 2006 of approximately $5.2 million, with an offset to common stock and additional paid-in capital.

The Company issues new shares when options are exercised. A summary of stock option activity during the Predecessor period ended July 6, 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	(2,496,006)	16.64
Exchanged for cash in Merger	(14,829,364)	18.53
Exchanged for Rollover Options	(2,225,175)	18.76
Canceled	(1,845,534)	22.17
Balance, July 6, 2007	-	$ -

During the Predecessor period from February 3, 2007 to July 6, 2007 and years ended February 2, 2007 and February 3, 2006, the weighted average grant date fair value of options granted was $5.37, $5.86 and $6.33, respectively; 4,213,373, 617,234 and 8,281,184 options vested, net of forfeitures, respectively; with a total fair value of approximately $23.6 million, $2.5 million and $56.5 million, respectively; and the total intrinsic value of stock options exercised was $10.8 million, $6.8 million and $16.7 million, respectively. The total intrinsic value of stock options exercised during the Successor period from July 7, 2007 to February 1, 2008 (all of which were Rollover Options) was $0.5 million.

At February 1, 2008, 1,799,102 Rollover Options were outstanding, all of which were exercisable. The aggregate intrinsic value of outstanding Rollover Options was $6.7 million with a weighted average remaining contractual term of 7.36 years, and a weighted average exercise price of $1.25.

All stock options granted prior to the Merger in the period ended July 6, 2007 and the year ended February 2, 2007 under the terms of the Company’s pre-merger 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 were to expire 10 years following the date of grant.

A summary of activity related to nonvested restricted stock and restricted stock unit awards during the Predecessor period ended July 6, 2007 is as follows:

	Nonvested Shares	Weighted Average Grant Date Fair Value
Balance, February 2, 2007	748,631	$ 16.63
Granted	749,508	21.17
Vested	(1,476,044)	18.83
Canceled	(22,095)	20.72
Balance, July 6, 2007	-	$ -

A summary of Time Options activity during the Successor period ended February 1, 2008 is as follows:

	Options Issued	Weighted Average Exercise Price
Granted	9,945,000	$ 5.00
Exercised	-	-
Canceled	(410,000)	5.00
Balance, February 1, 2008	9,535,000	$ 5.00

During the Successor period from July 7, 2007 to February 1, 2008, the weighted average grant date fair value of Time Options granted was $2.65; no options vested or were exercised. At February 1, 2008, the aggregate intrinsic value of outstanding 2007 Time Options was $0 with a weighted average remaining contractual term of 9.6 years. None of the outstanding Time Options are currently exercisable.

A summary of Performance Options activity during the Successor period ended February 1, 2008 is as follows:

	Options Issued	Weighted Average Exercise Price
Granted	9,945,000	$ 5.00
Exercised	-	-
Canceled	(410,000)	5.00
Balance, February 1, 2008	9,535,000	$ 5.00

During the Successor period from July 7, 2007 to February 1, 2008, the weighted average grant date fair value of Performance Options granted was $2.65; 1,907,000 Performance Options vested and are exercisable, net of forfeitures, with a total fair value of approximately $5.1 million, and none of those options were exercised. At February 1, 2008, the aggregate intrinsic value of outstanding 2007 Performance Options was $0 with a weighted average remaining contractual term of 9.6 years.

At February 1, 2008, the total unrecognized compensation cost related to non-vested stock options was $46.8 million with an expected weighted average expense recognition period of 4.4 years.

The Company currently believes that the performance targets related to the Performance Options will be achieved. If such goals are not met, and there is no change in control, no compensation cost relating to these Performance Options will be recognized and any compensation cost recognized to date will be reversed.

In January 2008, the Company granted 890,000 nonvested restricted shares to its CEO. These shares vest on the first to occur of (i) a change in control, (ii) an initial public offering, (iii) termination without cause or due to death or disability, or (iv) the last day of the Company’s 2011 fiscal year. These shares represent the only outstanding restricted shares as of February 1, 2008. At February 1, 2008, the total compensation cost related to nonvested restricted stock awards not yet recognized was approximately $4.4 million.

10. Related party transactions

Affiliates of certain of the Investors participated as (i) lenders in the Company's New Credit Facilities discussed in Note 6; (ii) initial purchasers of the Company's notes discussed in Note 6; (iii) counterparties to certain interest rate swaps discussed in Note 1 and (iv) as advisors in the Merger. Certain fees were paid upon closing of the Merger to affiliates of certain of the Investors. These fees primarily included underwriting fees, advisory fees, equity commitment fees, syndication fees, merger and acquisition fees, sponsor fees, costs of raising equity, and out of pocket expenses. The aggregate fees paid to these related parties during the Successor period ended February 1, 2008 totaled $134.9 million, portions of which have been capitalized as debt financing costs or as direct acquisition costs.

The Company entered into a monitoring agreement, dated July 6, 2007, with affiliates of certain of the Investors pursuant to which those entities will provide management and advisory services to the Company. Under the terms of the monitoring agreement, among other things, the Company is obliged to pay to those entities an aggregate annual management fee of $5.0 million payable in arrears at the end of each calendar quarter plus all reasonable out of pocket expenses incurred in connection with the provision of services under the agreement upon request. The fees incurred for the Successor period ended February 1, 2008 totaled $2.9 million. After the completion of the Company's first fiscal year, the management fee will increase at a rate of 5% per year. Those entities also are entitled to receive a fee equal to 1% of the gross transaction value in connection with certain subsequent financing, acquisition, disposition, and change in control transactions, as well as a termination fee in the event of an initial public offering or under certain other circumstances. In addition, on July 6, 2007, the Company also entered into a separate indemnification agreement with the parties to the monitoring agreement, pursuant to which the Company agreed to provide customary indemnification to such parties and their affiliates.

The Company uses Capstone Consulting, LLC, a team of executives who work exclusively with KKR portfolio companies providing certain consulting services. The Chief Executive Officer of Capstone serves on our Board. Although neither KKR nor any entity affiliated with KKR owns any of the equity of Capstone, prior to January 1, 2007 KKR had provided financing to Capstone. The aggregate fees incurred for Capstone services for the Successor period ended February 1, 2008 totaled $1.9 million.

The Company purchased a total of $25 million of the 11.857%/12.625% senior subordinated notes held by Goldman Sachs & Co. as further discussed in Note 6 and paid a commission of less than $0.1 million in connection therewith.

11. Capital stock

Prior to the Merger, the Company had a Shareholder Rights Plan (the "Rights Plan") under which Series B Junior Participating Preferred Stock Purchase Rights (the "Rights") were issued for each outstanding share of common stock. The Rights were attached to all common stock outstanding as of March 10, 2000. On May 8, 2000, the Company effected a five for four stock split at which time, pursuant to the adjustment provisions contained in the Rights

Agreement, each outstanding share of the Company's common stock evidenced the right to receive eight-tenths of a Right. Such Rights attached to all additional shares of common stock issued prior to the Plan's termination immediately prior to the effective date of the Merger. The Rights entitled the holders to purchase from the Company one one-hundredth of a share (a "Unit") of Series B Junior Participating Preferred Stock, no par value, at a purchase price of $100 per Unit, subject to adjustment, upon certain triggering events defined in the Plan. The Rights Plan terminated by its terms immediately prior to the effective date of the Merger. No Rights were exercised prior to that date.

On November 29, 2006, the Board of Directors authorized the Company to repurchase up to $500 million of its outstanding common stock. On September 30, 2005, the Board of Directors authorized the Company to repurchase up to 10 million shares of its outstanding common stock. These authorizations allowed for purchases in the open market or in privately negotiated transactions from time to time, subject to market conditions. The objective of the Company's share repurchase initiative was to enhance shareholder value by purchasing shares at a price that produced a return on investment that was greater than the Company's cost of capital. Additionally, share repurchases generally were undertaken only if such purchases resulted in an accretive impact on the Company's fully diluted earnings per share calculation. As a result of the Merger, the 2006 authorization is no longer outstanding. No purchases were made pursuant to this authorization. The 2005 authorization was completed prior to its expiration date. During 2006, the Company purchased approximately 4.5 million shares pursuant to the 2005 authorization at a total cost of $79.9 million. During 2005, the Company purchased approximately 5.5 million shares pursuant to the 2005 authorization at a total cost of $104.7 million and approximately 9.5 million shares pursuant to an earlier authorization at a total cost of $192.9 million.

12. Insurance settlement

During 2006 and 2005, the Company received proceeds of $13.0 million and $8.0 million, respectively, representing insurance recoveries for destroyed and damaged assets, costs incurred and business interruption coverage related to Hurricane Katrina, which are reflected in results of operations for these years as a reduction of SG&A expenses. The claim was settled in 2006. The business interruption portion of the proceeds was approximately $5.8 million and was received in 2006. Insurance recoveries related to fixed assets losses are included in cash flows from investing activities and recoveries related to inventory losses and business interruption are included in cash flows from operating activities.

13. Segment reporting

The Company manages its business on the basis of one reportable segment. See Note 1 for a brief description of the Company's business. As of February 1, 2008, all of the Company's operations were located within the United States with the exception of an immaterial Hong Kong subsidiary formed to assist in the process of importing certain merchandise that began operations in 2004. The following net sales data is presented in accordance with SFAS 131, "Disclosures about Segments of an Enterprise and Related Information."

(In thousands)	Successor July 7, 2007 through February 1, 2008	Predecessor February 1, 2007 through July 6, 2007	2006	2005
Classes of similar products:				
Highly consumable	$ 3,701,724	$ 2,615,110	$ 6,022,014	$ 5,606,466
Seasonal	908,301	604,935	1,509,999	1,348,769
Home products	507,027	362,725	914,357	907,826
Basic clothing	454,441	340,983	723,452	719,176
Net sales	$ 5,571,493	$ 3,923,753	$ 9,169,822	$ 8,582,237

14. Subsequent event

Subsequent to the 2007 fiscal year end, the Company entered into a $350.0 million step-down interest rate swap which became effective February 28, 2008 in order to mitigate an additional portion of the variable rate interest exposure under the New Credit Facilities discussed in Note 6. The Company entered into the swap with Wachovia Capital Markets and the terms result in the Company paying a fixed rate of 5.58% on a notional amount of $350.0 million for the first year and $150.0 million for the second year.

15. Quarterly financial data (unaudited)

The following is selected unaudited quarterly financial data for the fiscal years ended February 1, 2008 and February 2, 2007. Each quarter listed below was a 13-week accounting period. The sum of the four quarters for any given year may not equal annual totals due to rounding.

	Predecessor		Successor		
(In thousands)	First Quarter	May 5, 2007-July 6, 2007	July 7, 2007-August 3, 2007 (a)	Third Quarter	Fourth Quarter
2007:					
Net sales	$ 2,275,267	$ 1,648,486	$ 699,078	$ 2,312,842	$ 2,559,573
Gross profit	633,060	438,515	184,723	646,800	740,371
Operating profit (loss)	55,368	(46,120)	(6,025)	65,703	186,466
Net income (loss)	34,875	(42,873)	(27,175)	(33,032)	55,389

Predecessor	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2006:				
Net sales	$ 2,151,387	$ 2,251,053	$ 2,213,396	$ 2,553,986
Gross profit	584,274	611,534	526,447	645,950
Operating profit	81,285	80,577	3,339	83,075
Net income (loss)	47,670	45,468	(5,285)	50,090

(a) Includes the results of operations of Buck Acquisition Corp. for the period prior to its merger with and into Dollar General Corporation from March 6, 2007 (its formation) through July 6, 2007 (reflecting the change in fair value of interest rate swaps), and the post-merger results of Dollar General Corporation for the period from July 7, 2007 through February 1, 2008. See Notes 1 and 2.

As discussed in Note 2, in the Predecessor period ended July 6, 2007, the Company recorded transaction and other costs related to the Merger of $56.7 million and share-based compensation expense related directly to the Merger of $39.4 million as discussed in Note 9. As discussed in Note 2, in the Successor period ended August 3, 2007, the Company recorded transaction and other costs related to the Merger of $5.6 million, a loss on debt retirement related to the Merger of $6.2 million; a contingent loss related to certain DC leases of $8.6 million as discussed in Note 7; and a gain on certain interest rate swaps discussed in Note 1 of $6.8 million.

In the third quarter of 2007, the Company recorded an additional contingent loss related to certain DC leases of $3.4 million as discussed in Note 7. As discussed in Note 6, in the fourth quarter of 2007, the Company recorded a gain on debt retirement of $4.9 million.

As discussed in Note 12, during the first and third quarters of 2006, the Company received proceeds, net of taxes, of $3.2 million and $5.0 million, respectively, representing insurance recoveries for destroyed and damaged assets, costs incurred and business interruption coverage related to Hurricane Katrina, which is reflected in results of operations for these periods as a reduction of SG&A expenses.

As discussed in Note 3, in the third quarter of 2006, the Company completed a strategic review of its real estate portfolio and traditional inventory packaway strategy. The review resulted in plans to close approximately 400 underperforming stores and to eliminate nearly all packaway merchandise by the close of fiscal 2007. As a result, in the third quarter of 2006, the Company recorded SG&A charges and a lower of cost or market inventory impairment, which reduced the Company’s net income. Also, the change in merchandising strategy resulted in substantially higher markdowns on inventory in the fourth quarter of 2006 ($179.9 million at cost) negatively impacting gross profit and net income.

16. Guarantor subsidiaries

Certain of the Company’s subsidiaries (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 February 1, 2008		
SUCCESSOR	DOLLAR GENERAL CORPORATION	GUARANTOR SUBSIDIARIES	OTHER SUBSIDIARIES