PGDM, 2018-20

Advanced Financial Statement Analysis

311 **DM /IB** 308

Trimester –III, End-Term Examination: March 2019

Time allowed: 2 hrs and 30 mins | Max Marks: 50

Roll No: ____________

Instruction: Students are required to write Roll No on every page of the question paper, writing anything except the Roll No will be treated as **Unfair Means.** All other instructions on the reverse of Admit Card should be followed meticulously. Please carry a non-programmable calculator.

Case:

Please refer the enclosed case **Dollar General Going Private (DGGP).** Please attempt the following questions after carefully reading the case.

Questions:

1. Why are public firms such as Dollar General going private? (5)

2. i) What are your assessments of DGGP's performance over time and relative to its peers? What metrics would you focus on? Why? (10)

ii) What was the change in strategy? (5)

iii) How did it affect the reported financial results? How will it affect the future financial results? (5)

iv) Should Sadayo adjust the operating income and net income to account for special items (e.g. Inventory impairment charges)? If so, which special items? (5)

3. How do you explain the performance decline during the year ended February 2, 2007? (10)

4. As a shareholder of DGGP, should Sadayo vote to approve the deal with KKR? Why? (10)

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REV: JANUARY 16, 2008

SHARON KATZ

Dollar General Going Private

We are very pleased to announce a transaction that provides excellent value for our shareholders, representing a significant premium and the certainty of cash. . . . Our Board of Directors firmly believes that this is the right transaction for our shareholders, employees and customers.

—David A. Perdue, Chairman and Chief Executive Officer of Dollar General, Dollar General press release, March 12, 2007

Just hours after Dollar General said on Monday it agreed to the buyout by KKR, [shareholders'] lawyers filed the suit in Chancery Court in Nashville, which alleges Dollar General directors breached their fiduciary duty to stockholders and that the company is selling at a "grossly inadequate price." . . .

"Dollar General has begun moves to revitalize the company and presumably the stock price," said Doug Johnston, a lawyer for the plaintiff. "There hasn't been enough time to see if they're working. We believe they are. . . . We think the progress they've shown will continue and the next time they release their earnings, it will reflect that."

—*Associated Press*, March 13, 2007

Irina Sadayo (HBS, 2001), one of many retail shareholders of Dollar General Corporation (DG), debated whether to vote to approve a deal with Kohlberg Kravis Roberts & Co. (KKR). Concern that DG's selling price was "grossly inadequate," as claimed by some shareholders, was difficult to reconcile, however, with the apparently "generous" multiple, above and beyond those of comparable transactions and with a 31% premium above the current stock price. Further analysis clearly being needed, Sadayo decided to wait until the release of the 2006 annual report, expected by the end of March 2007, before making her decision.

Dollar General Corporation (NYSE: DG)[1]

Founded in 1939 as J.L. Turner & Son, a wholesale business in Scottsville, Kentucky, DG was a Fortune 500® company and the leader in the deep-discount retail channel, with more than 8,000 stores in 35 states, primarily in the southern and eastern United States, the Midwest, and the Southwest. The company pioneered the dollar-store concept in 1955, opening retail stores that sold all items for $1. The format was extremely successful, boosting the company's sales to $25.8 million by 1965. In 1968, the company tendered an initial public offering (IPO) and changed its name to Dollar General.

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[1] Hoover's Online database, Dollar General Corporation's 2006 10-K, and Dollar General's website, http://www.dollargeneral.com.

Professor Sharon Katz prepared this case. This case was developed from published sources. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

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Dollar General's Business Strategy[2]

To carry out its stated mission of "serving others," DG pursued a business strategy of providing customers with a focused assortment of fairly priced, consumable merchandise in a convenient, small-store format.

Customers DG served the basic consumable needs of customers primarily in the low- and middle-income brackets and on fixed incomes. In 2006, approximately 41% of its customers had gross incomes of less than $30,000 per year and approximately 24% gross incomes of less than $20,000 per year.

Stores The traditional DG store had, on average, approximately 6,900 square feet of selling space and generally served customers who lived within a five-mile radius. Of its 8,260 stores, 4,750 served communities with populations of 20,000 or fewer. In 2003, DG tested a Dollar General Market® store concept whereby 56 stores averaging 17,250 square feet of selling space began to carry, among other merchandise, an expanded assortment of grocery products and perishable items.

Merchandise DG offered assorted consumable merchandise in a number of core categories such as health and beauty aids, packaged food and refrigerated products, home cleaning supplies, housewares, stationery, seasonal goods, basic clothing, and domestics. This focused assortment of merchandise was meant to satisfy customers' everyday household needs. In 2006, the average customer purchase was $9.31.

Prices DG emphasized even-dollar prices on many items. In the typical store, most products were priced at $10 or less, approximately 30% at $1 or less.

Cost controls DG aggressively managed its overhead cost structure by, for example, locating stores in neighborhoods in which rent and operating costs were relatively low. It also attempted to control operating costs by implementing new technology where feasible.

2005 SEC Settlement

In 2005, DG reached a settlement with the Securities and Exchange Commission (SEC) regarding an investigation of accounting restatements from 1998 to 2001 that reduced DG's pretax income by a cumulative amount of $143 million. The SEC alleged that DG had manipulated earnings and failed to maintain adequate internal accounting controls. Additionally, the SEC claimed that DG executives knew about, or even influenced, practices employed to meet or beat analysts' expectations and maintain employees' bonuses. DG paid $10 million in civil penalties and incurred a permanent civil injunction against future violations but neither admitted nor denied the allegations. DG's then-CEO Hurley Cal Turner Jr. agreed to pay a $1 million fine.[3]

Recent Stock Price

DG's stock price had declined steadily throughout the first three quarters of 2006, finally hitting a 52-week low of $12.10 in September 2006. During this period, DG reported reduced same-store sales and missed analysts' expectations several times. Uncertainty arising from takeover speculation and announced plans to close underperforming stores pushed the company's price down even further.

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[2] Dollar General Corporation's 2006 10-K.

[3] "Dollar General Settles with SEC," *Associated Press*, April 7, 2005.

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By the fall of 2006, in an effort to restructure its business model, DG abandoned its "packaway" inventory model, whereby it kept unsold inventory instead of moving it through clearance markdowns, and announced plans to open 535 new stores. The company also repurchased approximately 4.5 million shares of its common stock. By February 2007, DG reported a total sales increase of 4.9%, beating Wall Street forecasts of 4.6%. When KKR announced its plan to acquire DG at a price representing more than a 30% premium, shares went up $4.29 to close at $21.18. (See **Exhibit 1** for a stock price graph.)

Deep-Discount Retail Channel[4]

The deep-discount retail segment was broadly divided into the following categories:

Extreme value retailers such as Family Dollar, Dollar General, and Fred's sold deeply discounted merchandise at prices that typically ranged from $1 to $20.

Closeout stores such as Big Lots and Odd Jobs offered a wide variety of merchandise typically at 40%–80% below standard retail prices. These types of stores tended to carry more substantial or expensive items such as furniture, home furnishings, and seasonal merchandise.

Single-price stores such as 99¢ Only Stores and Dollar Tree sold merchandise only for the price advertised in the store's name (i.e., 99 cents or $1). These retailers sold a wide selection of often name-brand closeout and regularly available consumable products including food, household supplies, and health- and beauty-care products.

The deep-discount retail channel was highly competitive. In addition to various local and independent operators, deep-discount stores competed with mass-discount merchandisers such as Wal-Mart and Walgreens and convenience stores. (Brief descriptions of DG's main competitors are provided in **Exhibit 2**.)

Between 2000 and 2005, the deep-discount channel grew by $12.2 billion, to $33.2 billion. This annual average growth of 11.8% was variously attributed to the mainstreaming and legitimization of the deep-discount store channel, consolidation in the space, and record numbers of new store openings. According to a Mintel research report, total U.S. retail sales in deep-discount stores were predicted to exceed $48 billion by 2010.[5]

The reputation of the deep-discount store channel improved as a consequence of more appealing store layouts, higher overall product quality, and the addition of national brands and more consistent merchandising mixes; a greater proportion of middle- and high-income consumers began to frequent the channel in search of "treasure hunt" merchandise. According to a Mintel research report, massive deep-discount store expansion was partially responsible for growing consumer appreciation of the channel, which enabled large chains to realize economies of scale and produce well-functioning distribution networks.[6]

But the pace of growth witnessed over the past few years in the deep-discount store channel was most likely unsustainable. That growth had been due almost entirely to new store openings, since same-store sales had remained virtually flat. While the number of possible new outlets for deep-discount stores declined and existing deep-discount store retailers (either independents or regionally

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4 "Dollar Stores—US," Mintel, December 2005, and Dollar General Corporation's 2006 10-K.

5 Ibid.

6 Ibid.

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strong deep-discount store chains) crowded out newcomers, the major deep-discount store retail brands were likely to face decline. (The market share of various players in the deep-discount retail segment is shown in **Exhibit 3**; **Exhibit 4** presents forecasts of total U.S. retail sales in deep-discount retail channel stores for the period 2006–2010.)

Leveraged Buyout (LBO)

LBO Transaction

A leveraged buyout (LBO) involved the use of a significant amount of borrowed money or debt (e.g., loans or bonds) to acquire a company or division of a company. LBO transactions enabled private-equity firms and LBO investors to make large acquisitions without committing a great deal of their own capital. It was not unusual in a typical LBO transaction to see a ratio of 90% debt to 10% equity. The financing for such deals was usually borrowed in the public markets by issuing high-yield, high-risk debt instruments (sometimes called "junk bonds"). Thus, the term "leveraged buyout." In many LBO arrangements, private-equity firms or management bought up all the outstanding shares of a company's stock (sometimes referred to as "going private") and used the company assets as collateral for a loan to fund the purchase. These loans were later repaid out of future cash flows or with proceeds from the sale of the company's assets. In some LBOs, the continuing effort of the management team was central to the success of the offer, while in other cases the management team was removed.

LBO Market

LBO strategies became popular in the 1980s due primarily to growth in public debt markets that made it possible for greater numbers of borrowers to access large amounts of capital. When private-equity investors in LBO deals realized that they could achieve returns of 20% to 25%, LBOs really took off. By 1989, the total revenue in LBO transactions in the United States exceeded $76.6 billion. In the late 1990s, when several prominent buyouts led to the eventual bankruptcy of the acquired companies, the industry experienced a setback. A number of precautionary measures were conceived to make corporations less vulnerable to LBOs. The most famous was the poison pill, by means of which a corporation ensured that its valuation would fall dramatically in the event of a hostile takeover.

In the early 2000s, macro- and microeconomic indicators once again suggested that conditions were ripe for buyout firms. Debt was available at historically record low interest rates, and the market seemed more receptive to IPOs, which promised greater exit opportunities. According to London-based financial information firm Private Equity Intelligence, in 2004 LBO funds raised approximately $145 billion of private equity, primarily from pension funds.[7]

Enthusiasm for LBOs peaked in 2005, fueled by three forces: lots of cash in the hands of institutional investors and wealthy individuals who wanted higher returns; a growing number of investment firms with track records in finding underperforming or undervalued public companies or units within those companies; and a strong economy that had debt available at low interest rates. Some 3,000 private-equity funds held $150 billion in capital, and approximately 9,000 hedge funds had nearly $1 trillion in assets.[8] With trading and other short-term investment strategies becoming less lucrative, even hedge funds such as Cerberus Capital Management and Highfields Capital were

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[7] "Buyout Competition: The Emergence of Hedge Funds in the World of Private Equity," *The Journal of Private Equity*, Winter 2005.

[8] "Private Equity's Hedge Fund Edge: Carlyle Starts Second Hedge Fund; Thomas H. Lee Raises $6 billion," *The Investment Dealers' Digest*, February 28, 2005.

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acting like buyout firms, either purchasing large controlling stakes in other companies or taking a more active role in the management of the companies they invested in.[9]

Between 2004 and 2006, buyout firms averaged a 15.6% return on their investments, compared with 9.9% for the S&P 500.[10] In 2006, private-equity firms bought a total of 654 U.S. companies—which accounted for a quarter of all U.S. mergers and acquisitions that year and was 18 times the level in 2003—for a record $375 billion. Nine of the 10 largest buyouts occurred in 2006, including office landlord Equity Office Partner's Trust for $39 billion and hospital manager HCA for $33 billion.[11]

The Transaction[12]

On March 11, 2007, Dollar General's board agreed to a buyout offer of approximately $6.9 billion from affiliates of private-equity firm KKR. As part of the deal that would take the company private, KKR would assume $380 million in debt.

As a private company, DG would be controlled by affiliates of KKR, its common stock would no longer be listed on any stock exchange or quotation system, and the registration thereof and attendant reporting obligations under the Securities Exchange Act of 1934 would be terminated.

Under the agreement, DG shareholders would receive, per share, $22.00 in cash, a 31.1% premium over DG's closing price of $16.78 on March 9, 2007, and an approximately 29% premium over the average closing price during the previous 30 trading days. Moreover, the proposed enterprise value over operating income multiple[13] for DG was well above comparable retail transaction multiples in the past few years.

Consummation of the merger agreement, approved unanimously by DG's board of directors, was subject to approval by the shareholders. A special shareholders meeting was scheduled for June 2007. The deal was expected to be completed in the third quarter of that year.[14]

The Lawsuit

On March 12, 2007, a few hours after the merger was announced, DG shareholder William Hochman filed a complaint against the company, its board of directors, and KKR arguing that the merger was "pursuant to an unfair process and at a grossly inadequate price of $22."[15] The plaintiff

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[9] "Buyout Competition: The Emergence of Hedge Funds in the World of Private Equity," *The Journal of Private Equity*, Winter 2005.

[10] "The buyout binge," *Economist Intelligence Unit—Executive Briefing*, May 2, 2007.

[11] "The Enigma of Private Equity: Do leveraged buyouts permanently improve companies and ultimately raise living standards?" *Newsweek*, March 19, 2007.

[12] Dollar General Corporation's 2006 10-K.

[13] Enterprise value is a measure of the company value. It is calculated as the market capitalization ($22 per share x 314 million shares outstanding, which equals $6.9 billion) plus the assumptions of approximately $380 million in net debt. Net debt is defined as total debt minus cash, cash equivalents, and short-term investments.

[14] If the merger was not completed, DG would be required, under certain circumstances, to pay KKR a termination fee of up to $225 million. These circumstances included, among others, termination of the merger agreement by DG in order for it to enter into a definitive agreement with respect to a superior proposal.

[15] William Hochman was represented by the law firm Barrett, Johnston & Parsley in Nashville, which was the first to file after the Central Parking, HCA, iPayment, and Thomas Nelson buyout announcements, and it became lead plaintiff's counsel in each of those cases ("Shareholder lawsuit targets Dollar General buyout," *Nashville Post*, March 12, 2007).

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further argued that the board of directors rushed to complete a merger agreement prior to March 26, 2007 because DG was scheduled to announce its earnings for the year on that day, and the financial results would have caused the company's shares to skyrocket. The lawsuit maintained, "If that happens, it could cost management and KKR tens, if not hundreds, of millions of dollars more to acquire Dollar General." The lawsuit also argued that the "no-shop" provision and termination fee totaling $225 million "effectively ensures the sale to KKR and KKR only . . . and also discourages other potential bidders from emerging."[16]

Shareholders' lawyers further argued that DG's recent strategic initiatives would likely boost its earnings and stock price and that shareholders should be getting more than the current offer.

In addition, debt investors were not so keen. Debt financing provided for the deal by Goldman Sachs and Lehman Brothers would translate into additional payments owed by Dollar General in coming years. Moody's Investors Service put Dollar General's Ba1 debt rating on review for a possible downgrade, explaining that the merger with KKR "will result in significant increase in the company's leverage and a corresponding weakening in credit metrics at a time when the company's operating performance has been weak."[17]

Dollar General's 2006 Annual Report and Recent Strategic Initiatives[18]

DG issued its annual report for the fiscal year ended February 2, 2007 at the end of March 2007. Examining the income statement, Sadayo was surprised to see a sharp decline in net income during the year, from $350.2 million in 2005 to only $137.9 million in 2006, despite increased revenues. Moreover, whereas revenues increased by $587.6 million, cost of goods sold increased by $684.2 million. (Exhibit 5 presents Dollar General's 2006 financial statements together with Sadayo's calculations of common-size income statements and balance sheets. The exhibit also contains selected excerpts from Dollar General's summary of critical accounting policies and estimates.) To better understand what happened, Sadayo turned to the "management's discussion and analysis of financial condition and results of operations" (MD&A) section of the annual report, where she read about the following recent strategic initiatives DG had implemented.[19]

Inventory Management

In November 2006, DG announced a plan to minimize the amount of store merchandise it carried over to subsequent periods ("packaway"). In the fourth quarter of fiscal 2006, DG began a significant effort to sell through this inventory. By using end-of-season and other markdowns, DG planned to eliminate, by the end of fiscal 2007, existing seasonal, home, and apparel packaway inventories in order to make way for newer, fresher items and more appealing merchandise.

To maximize the financial returns of this initiative while accelerating the sell-through of targeted inventory, DG developed a schedule for markdowns and established an oversight team to monitor its efforts. DG utilized television and radio advertising to increase awareness of its effort as well as to introduce potential customers to its brand and everyday product offerings.

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[16] "Shareholder suit calls Dollar General buyout 'grossly inadequate,'" *Associated Press*, March 13, 2007, and court filings.

[17] "KKR Seals a Deal for Dollar General: Shares of the discount retailer jumped nearly 26% on news of the buyout," BusinessWeek Online, March 13, 2007.

[18] 2006 Annual Report refers to the fiscal year ended February 2, 2007.

[19] Dollar General Corporation's 2006 10-K.

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DG discontinued its traditional inventory packaway management model in an attempt to better meet its customers' needs and ensure an appealing, fresh merchandise selection. Beginning in fiscal 2007, DG was planning to increase levels of newer, current-season merchandise by taking end-of-season markdowns on virtually all current-year, nonreplenishable merchandise. It believed that its revised strategy would enhance the appearance of its stores and have a positive impact on both customer satisfaction and store employees' ability to manage stores. DG expected these changes to yield higher sales and gross profit, reduce employee turnover and inventory shrink and damage, and improve inventory management, resulting in more appropriate per store inventory levels.[20]

Real Estate Strategy

In November 2006, DG announced significant changes to its real estate strategy. As part of a plan, approved by the board of directors, to enhance the store experience for customers, DG announced that it would close, by the end of fiscal 2007, approximately 400 stores that did not meet its real estate criteria. Further, it would remodel or relocate approximately 300 stores during fiscal 2007 and decelerate new store openings, with the expectation of opening 300 new stores in fiscal 2007.

During fiscal 2006, DG opened 537 new stores and closed 237 stores, including the 128 store closings identified in its strategic review (see **Table A** below).

Table A

Year	Stores at Beginning of Year	Stores Opened	Stores Closed	Net Stores Increase	Stores at End of Year
2004	6,700	722	102	620	7,320
2005	7,320	734	125[a]	609	7,929
2006	7,929	537	237[b]	300	8,229

Source: Dollar General Corporation's 2006 10-K.

[a]Includes 41 stores closed as a result of hurricane damage.

[b]Includes 128 stores closed as a result of certain recent strategic initiatives.

Impact on Financial Statements

DG's accelerated implementation of a new inventory management policy led to substantially higher markdowns on inventory. Total markdowns, including inventory impairment charges, of $279.1 million at cost were taken during 2006, compared with total markdowns of $106.5 million at cost taken in 2005.

[20] DG experienced inventory shrinkage, stated as a percentage of sales, of 3.40% in 2006, 3.22% in 2005, and 3.05% in 2004. Inventory shrinkage is the difference between the inventory a company should have on its books (as a results of its sales, purchasing, and manufacturing processes) and the physical inventory it has on hand. This reduction in physical inventory was caused primarily by employee theft, customer shoplifting, administrative error, vendor fraud, deterioration, loss, and damage.

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Markdowns expected to reduce inventory *below cost* were recorded as the lower of cost or market inventory impairment.[21] The *inventory impairment* estimate related to the initiatives discussed above totaled $70.2 million in fiscal 2006 and reduced 2006 gross profit by a corresponding amount.

Markdowns that were not below cost also affected DG's gross profit in the period in which the markdowns were taken.

DG expected the higher level of markdowns to continue throughout 2007 and predicted gross profit margins to consequently be around 27% in 2007, 28% in 2008, and 29% in 2009. DG further estimated total pretax selling, general, and administrative (SG&A) charges associated with the inventory and real estate initiatives at approximately $104.6 million, approximately $33.4 million of which was reflected in its results of operations during 2006 (see **Table B** below).

Table B

(amount in millions)	Estimated Total	Incurred in 2006	Remaining
Lease contract termination costs	$38.1	$5.7	$32.4
One-time employee termination benefits	1.4	0.3	1.1
Other associated store-closing costs	9.0	0.2	8.8
Inventory liquidation fees	5.0	1.6	3.4
Asset impairment and accelerated depreciation	9.0	8.3	0.7
Other costs[a]	42.1	17.3	24.8
	$104.6	*$33.4*	*$71.2*

Source: Dollar General Corporation's 2006 10-K.

[a] Includes incremental store labor, advertising, and other costs.

The increase in SG&A expense as a percentage of sales, from 22.2% in 2005 to 23.1% in 2006, was also due to the following factors:

- Additional $1.4 million impairment charges on leasehold improvement and store fixtures
- Higher store occupancy costs (increased 12.1%) due to higher monthly rents
- Higher debit and credit card fees (increased 40.6%) due to increased customer use of debit cards and acceptance of credit and check cards at all locations
- Higher administrative labor costs (increased 29.9%) primarily related to recent additions to the executive team and expensing of employee stock options
- Higher advertising costs (increased 198.3%)

[21] Inventories should be measured at their purchase costs in conformity with the cost principle. When the goods remaining in ending inventory can be replaced with identical goods at a lower cost, however, the lower "replacement cost" should be used as the inventory valuation. Also, damaged and absolute items in inventory should be assigned a unit cost that represents their current estimated net realizable value ("market value") if that is below cost (R. Libby, P. A. Libby, and D. G. Short, *Financial Accounting*, [Irwin, 1996], p. 373).

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- Higher incentive compensation primarily related to the $9.6 million employee discretionary bonus authorized by the board of directors

These increases were partially offset by insurance proceeds of $13 million received during the current-year period related to losses incurred as a consequence of Hurricane Katrina.

Sadayo's Analysis

Sadayo began her analysis by computing the financial ratios for DG and examining the common-size income statement and balance sheet. (See **Exhibit 6** for Sadayo's ratios analysis for Dollar General.) To gain further insight into Dollar General's financials, Sadayo calculated the financial ratios of several comparable firms in the deep-discount retail channel identified by DG as its main competitors. (Spreadsheets with ratio analysis, key financials, and common-size income statements and balance sheets for these comparable firms are provided in **Exhibit 7**.) She also looked at comparable transactions in the retail industry over the past few years (see **Exhibit 8**).

Finally, Sadayo wanted to better understand what management would gain from the proposed LBO (as implied by the lawsuit). Due to the accelerated vesting and cashing out of certain equity-compensation items, she estimated that DG Chairman and CEO David A. Perdue would realize about $28 million from the transaction. (See **Exhibit 9** for excerpts from DG's 2007 schedule 14A regarding the interests of its directors and executive officers in the merger; **Exhibit 10** provides biographies of the members of DG's board of directors.)

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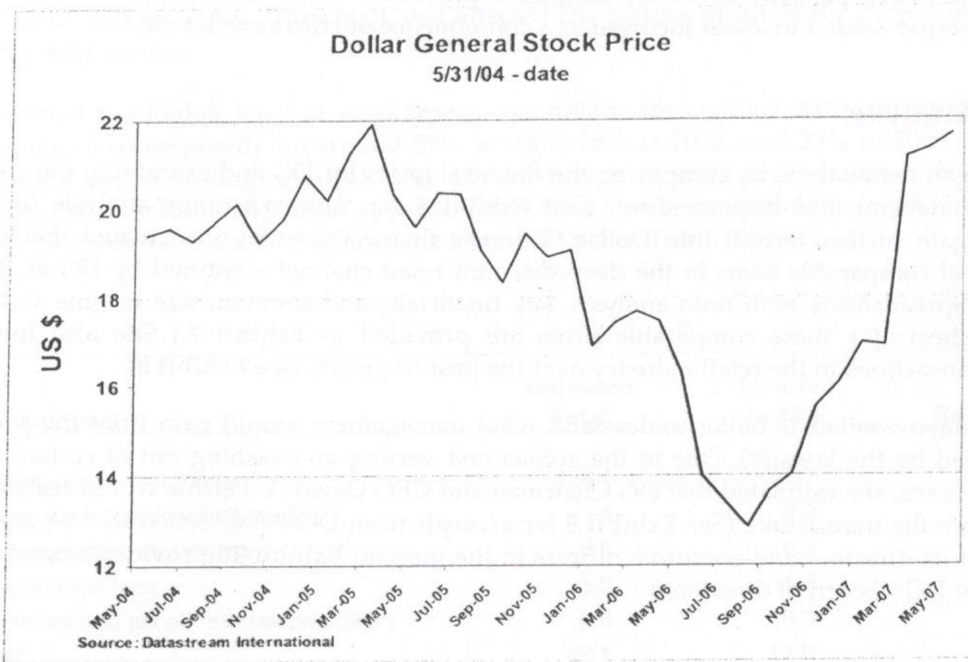
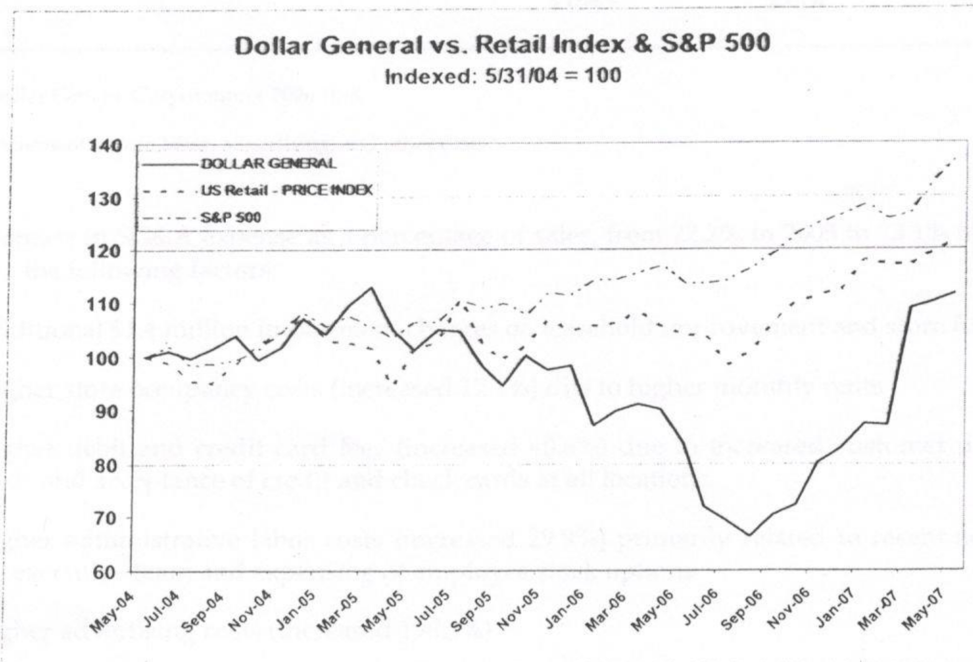
Exhibit 1 Dollar General Corporation (Ticker: DG): Stock Price Performance





Source: Thomson Datastream, accessed June 14, 2007.

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Exhibit 2 Description of Dollar General's Main Competitors

Family Dollar Stores, Inc. [NYSE: FDO]

Founded in 1959, Family Dollar, the nation's number two dollar store, targets women shopping for a family that earns around $25,000 per year. Family Dollar operates around 6,300 stores in 44 states. Consumables account for more than half of sales; the stores also sell apparel, shoes, and linens. The company emphasizes neighborhood stores near its low- and middle-income customers in rural and urban areas. Most merchandise sells for less than $10.

The pace of new store openings has slowed in recent years. After opening some 275 stores (net of closings) in fiscal 2006, Family Dollar Stores plans to open another 250 this year. Same-store sales rose from 2.3% in 2005 to 3.7% in 2006. In addition, the discount chain has been increasing its retail presence in urban areas, with 50% of the new stores added in 2006 in urban markets.[a]

As part of its 2005 "urban initiative," Family Dollar employed more human resources and loss-prevention specialists for urban markets than for similar numbers of stores in rural markets. In addition, the urban initiative called for tailoring merchandise to the urban stores' clientele rather than stocking the same things found in rural stores.

Family Dollar also incorporated "zone pricing," a practice of raising or lowering prices on given items in individual stores in response to demographic or competitive pressures. Some retailers, including Dollar General, used primarily a "uniform pricing" approach that called for keeping the price of a given item consistent from store to store.

The retailer is expanding its food offering to include milk and other perishables. To that end, Family Dollar has installed refrigerated coolers in about 3,800 stores. In addition to selling more groceries, it will begin accepting food stamps to attract more low-income customers to its stores.

Eventually, according to management, Family Dollar would like to expand westward into California, Idaho, Montana, Oregon, and Washington. International expansion may also be on the horizon.

Fred's, Inc. [NYSE: FRED]

Fred's operates 675 discount stores in 15 mostly southeastern states, primarily in small towns. Nearly 45% of Fred's stores have full-service pharmacies (it also fills mail-order prescriptions). The retailer opened 55 stores last year and expects to increase its store count by as many as 40 new locations in 2007. Fred's is also anticipating adding 15 to 25 pharmacies to its stores this year.

Fred's responded to Wal-Mart's announcement in September 2006 that it was lowering prices on generic drugs to $4 per prescription by following suit in select stores. Fred's said it will evaluate the success of the program and possibly extend it to other markets as Wal-Mart did.

Dollar Tree Stores, Inc. [NASDAQ (GS): DLTR]

Dollar Tree Stores' 3,200-plus discount stores in 48 states sell a changing mix of housewares, toys, seasonal items, food, health and beauty aids, gifts, and books, all priced at $1 or less. About 40% of its merchandise is imported, primarily from China. Closeouts represent less than 15% of its inventory. Dollar Tree Stores are located in high-traffic strip centers anchored by mass merchandisers and

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supermarkets as well as in small towns. In recent years, Dollar Tree has begun opening larger stores (approximately 10,000–15,000 sq. ft.).

The one-price retailer also operates stores under the Dollar Bills and Dollar Express banners. Dollar Tree's acquisition of the 138-store Deal$ chain in March 2006 afforded it an opportunity to test selling merchandise for more than $1. Previous acquisitions include the Dollar Express chain in 2000 and the 100-store Greenbacks chain.

Dollar Tree has added frozen and refrigerated food coolers to about 700 stores. The one-price chain already sells branded and private-label dry grocery items priced at $1.[b]

Last year the retailer opened about 300 new stores. Although the majority of the chain's stores are located in rural and suburban markets, Dollar Tree is beginning to move into big cities with more affluent shoppers.

99 Cents Only Stores [NYSE: NDN]

99 Cents Only Stores sells closeout and regular general merchandise for 99 cents or less. Its approximately 230 stores sell name-brand and private-label food and beverages, health and beauty aids, household goods, and toys, among other merchandise. Most of the stores are in southern California. The firm's Bargain Wholesale unit distributes discounted merchandise to retailers, distributors, and exporters. The Gold family owns more than one-third of the company and is actively involved in running it.

The deep-discount retailer opened its first store in Texas in mid-2003, but sales have been disappointing. To fix its Texas business, 99 Cents Only Stores has introduced a new 99-cents-and-less pricing policy and is building smaller stores there.

Insufficient capacity at its Los Angeles distribution center, which led to late deliveries and supply problems, and deep discounting by supermarkets to win back customers in the aftermath of the southern California grocery workers strike have hurt the company's business.

99 Cents Only Stores has retained BDO Seidman, LLP as its new audit firm, following the resignation of Deloitte & Touche LLP in September 2005.

Source: Hoover's Online database and "Dollar General Lags Behind Rival—Family Dollar Makes Successful Approach into Urban Markets," *The Wall Street Journal*, March 26, 2007.

[a] According to ACNielsen, the 11.7% of Dollar General's stores located in densely populated urban counties compares with 22.7% of Family Dollar's stores. Moreover, 12.4% of the U.S. population lives within one mile of a Dollar General store. Due primarily to its urban focus, for Family Dollar that figure is 17.2%.

[b] Other dollar chains, notably Dollar General, have been aggressively adding food to their merchandise mix to boost sales.

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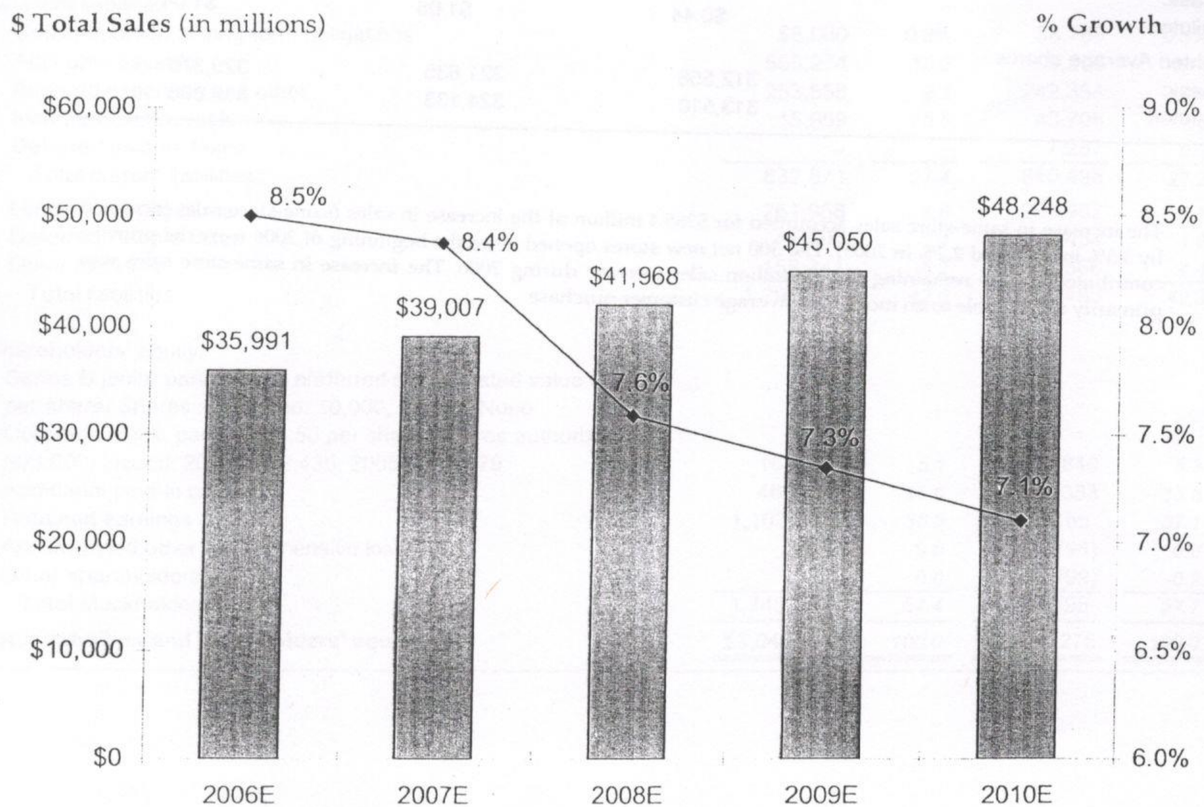
Exhibit 3 Market Share in the Deep-Discount Retail Channel

Retailer	2004	2005	2006
Dollar General	25.3%	25.9%	25.5%
Family Dollar	18.5%	18.4%	18.6%
Dollar Tree	10.3%	10.2%	11.0%
Fred's	4.8%	4.8%	4.9%
99 Cent Only	3.3%	3.1%	3.0%
Total Top Retailers	62.1%	62.4%	63.0%

Source: "Dollar Stores—US," Mintel, December 2005; AC Nielsen; companies' 10-Ks; and author's calculations.

Exhibit 4 Forecast of Total U.S. Sales in Deep-Discount Retail Segment, 2006–2010



Source: "Dollar Stores—US," Mintel December 2005; AC Nielsen; and author's calculations.

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Exhibit 5 Dollar General Corporation, 2006 Financial Statements

Statement of Income (amounts in thousands)

Fiscal years ended February 2,	2007 (52 weeks)		2006 (53 weeks)		2005 (52 weeks)	
Net sales	$9,169,822	*100%*	$8,582,237	*100%*	$7,660,927	*100%*
Cost of goods sold	6,801,617	*74.2*	6,117,413	*71.3*	5,397,735	*70.5*
Gross profit	2,368,205	*25.8*	2,464,824	*28.7*	2,263,192	*29.5*
Selling, general & administrative expense	2,119,929	*23.1*	1,902,957	*22.2*	1,706,216	*22.3*
Operating income	248,276	*2.7*	561,867	*6.5*	556,976	*7.3*
Interest income	(7,002)	*-0.1*	(9,001)	*-0.1*	(6,575)	*-0.1*
Interest expense	34,915	*0.4*	26,226	*0.3*	28,794	*0.4*
Income before income taxes	220,363	*2.4*	544,642	*6.3*	534,757	*7.0*
Income tax expense	82,420	*0.9*	194,487	*2.3*	190,567	*2.5*
Net income	$137,943	*1.5*	$350,155	*4.1*	$344,190	*4.5*
Earnings per share:						
Basic	$0.44		$1.09		$1.04	
Diluted	$0.44		$1.08		$1.04	
Weighted Average shares:						
Basic	312,556		321,835		329,376	
Diluted	313,510		324,133		332,068	

Note: **The increase in same-store sales accounted for $265.4 million of the increase in sales (same-store sales increased by 3.3% in 2006 and 2.2% in 2005). The 300 net new stores opened since the beginning of 2006 were the primary contributors of the remaining $322.2 million sales increase during 2006. The increase in same-store sales was primarily attributable to an increase in average customer purchase.**

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Exhibit 5 (continued)

Balance Sheets (amounts in thousands)

Fiscal years ended February 2,	2007		2006	
Assets				
Current assets:				
Cash and cash equivalents	$189,288	6.2%	$200,609	6.7%
Short-term investments	29,950	1.0	8,850	0.3
Merchandise inventories	1,432,336	47.1	1,474,414	49.5
Income taxes receivable	9,833	0.3	--	--
Deferred income taxes	24,321	0.8	--	--
Prepaid expenses and other current assets	57,020	1.9	51,339	1.7
Total current assets	1,742,748	57.3	1,735,212	58.2
Property, plant and equipment, net	1,236,874	40.7	1,192,172	40.0
Other assets, net	60,892	2.0	52,891	1.8
Total assets	$3,040,514	100.0	$2,980,275	100.0
Liabilities and stockholders' equity				
Current liabilities:				
Current portion of long-term obligations	$8,080	0.3%	$8,785	0.3%
Accounts payable	555,274	18.3	508,386	17.1
Accrued expenses and other	253,558	8.3	242,354	8.1
Income taxes payable	15,959	0.5	43,706	1.5
Deferred income taxes	--	--	7,267	0.2
Total current liabilities	832,871	27.4	810,498	27.2
Long-term obligations	261,958	8.6	269,962	9.1
Deferred income taxes	41,597	1.4	48,454	1.6
Other liabilities	158,341	5.2	130,566	4.4
Total liabilities	1,294,767	42.6	1,259,480	42.3
Shareholders' equity:				
Series B junior participating preferred stock, stated value $0.50 per share; Shares authorized: 10,000; Issued: None	--		--	
Common stock, par value $.50 per share; Shares authorized: 500,000; Issued: 2006 - 312,436; 2005 - 315,679	156,218	5.1	157,840	5.3
Additional paid-in capital	486,145	16.0	462,383	15.5
Retained earnings	1,103,951	36.3	1,106,165	37.1
Accumulated other comprehensive loss	(987)	0.0	(794)	0.0
Other shareholders' equity	420	0.0	(4,799)	-0.2
Total stockholders' equity	1,745,747	57.4	1,720,795	57.7
Total liabilities and stockholders' equity	$3,040,514	100.0	$2,980,275	100.0

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Exhibit 5 (continued)

Statements of Cash Flows (amounts in thousands)

Fiscal years ended February 2,	2007 (52 weeks)	2006 (53 weeks)	2005 (52 weeks)
Cash flow from operating activities:			
Net Income	$137,943	$350,155	$344,190
Adjustments to reconcile net income to net cash:			
Depreciation and amortization	200,608	186,824	164,478
Deferred income taxes	(38,218)	8,244	25,751
Noncash share-based compensation	7,578	3,332	1,779
Tax benefit from stock option exercises	(2,513)	6,457	9,657
Noncash inventory adjustments and assets impairments	78,115	--	--
Changes in operating assets and liabilities:			
Merchandise inventories	(28,057)	(97,877)	(219,396)
Prepaid expenses and other current assets	(5,411)	(10,630)	(3,352)
Accounts payable	53,544	87,230	22,258
Accrued expenses and other liabilities	38,353	40,376	35,048
Income taxes	(35,165)	(26,017)	23,793
Other	(1,420)	7,391	(12,691)
Net cash provided by operating activities	$405,357	$555,485	$391,515
Cash flow from investing activities:			
Purchase of property, plant and equipment	($261,515)	($284,112)	($288,294)
Purchase of short-term investments	(49,675)	(132,775)	(221,700)
Sale of short-term investments	51,525	166,850	247,501
Purchase of long-term investments	(25,756)	(16,995)	--
Insurance proceeds related to property and equipment	1,807	1,210	--
Proceeds from sale of property and equipment	1,650	1,419	3,324
Net cash used in investing activities	($281,964)	($264,403)	($259,169)
Cash flow from financing activities:			
Borrowing under revolving credit facility	$2,012,700	232,200	195,000
Repayments of borrowings under revolving credit facility	(2,012,700)	(232,200)	(195,000)
Issuance of long-term obligations	--	14,495	--
Repayments of long-term obligations	(14,118)	(14,310)	(16,417)
Payment of cash dividends	(62,472)	(56,183)	(52,682)
Proceeds from exercise of stock options	19,894	29,405	34,128
Repurchase common stock	(79,947)	(297,602)	(209,295)
Tax benefit of stock options	2,513		--
Other financing activities	(584)	892	(1,149)
Net cash used in financing activities	($134,714)	($323,303)	($245,415)
Change in cash and cash equivalents	($11,321)	($32,221)	($113,069)
Cash and cash equivalents, beginning of year	200,609	232,830	345,899
Cash and cash equivalents, end of year	$189,288	$200,609	$232,830
Supplemental cash flow information:			
Cash paid during the year for:			
Interest	$24,180	$25,747	$26,748
Income taxes	155,825	205,802	133,100

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Exhibit 5 (continued) Selected Excerpts Dollar General Corp., 2006 Summary of Significant Accounting Policies

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 DG's financial statements that require estimation, but are not deemed critical as defined below. DG believes 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.

Revenue and Gain Recognition

DG 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 DG's prior experience. DG records gain contingencies when realized.

DG began gift card sales in the third quarter of 2005. DG 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 $0.8 million and $0.5 million on February 2, 2007 and February 3, 2006, respectively, and is recorded in Accrued expenses and other.

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 its retail inventory method (RIM),[22] the calculation of gross profit and 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.

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[22] The retail inventory method is an accounting method used for inventory control and formulation of purchasing policy by retail businesses. Both selling price and cost of the inventory are taken into account. "Here is how it works: the sales for the period are deducted from the retail value of the goods available for sale to produce an estimated inventory (goods on hand) at retail. The ratio of cost to retail for all goods passing through the firm is then determined by dividing the total goods available for sale at cost by the total goods available at retail. The inventory valued at retail is converted to ending inventory at cost by applying the cost-to-retail ratio." The retail inventory method is illustrated below:

	Cost	Retail
Beginning inventory	$14,000	$18,000
Purchases	68,500	92,000
Goods available for sale	$82,500	$110,000
Deduct sales		90,000
Ending inventory, at retail		$20,000
Ratio of cost to retail ($82,500/ $110,000)		75%
Ending inventory at cost (75% of $20,000)		$15,000

D. E. Kieso and J. J. Weygandt, *Intermediate Accounting* (New York: John Wiley & Sons, Inc., 1993), pp. 461–462.

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Property and Equipment

Property and equipment are recorded at cost. DG groups its assets into relatively homogeneous classes and generally provides for depreciation on a straight-line basis over the estimated average useful life of each asset class, except for leasehold improvements, which are amortized over the shorter of the applicable lease term or the estimated useful life of the asset. The valuation and classification of these assets and assignment of useful depreciable lives involve significant judgments and the use of estimates.

Impairment of Long-lived Assets

DG reviews 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," DG 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. DG's estimate of undiscounted future cash flows over the lease term is based on 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 on future cash flows (discounted at credit adjusted risk-free rate)[23] or other reasonable estimates of fair market value.

Contingent Liabilities—Legal Matters

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

Lease Accounting and Excess Facilities

The majority of DG's stores are subject to short-term leases (usually with initial or primary terms of 3 to 5 years) with multiple renewal options when available. DG also has stores subject to build-to-suit arrangements with landlords, which typically carry a primary lease term of between 7 and 10 years with multiple renewal options. Approximately half of its stores have provisions for contingent rentals based on a percentage of defined sales volume. DG recognizes contingent rental expense when the achievement of specified sales targets is considered probable. DG recognizes rent expense over the term of the lease. DG records minimum rental expense on a straight-line basis over the base,

[23] A risk-free rate (such as that for zero-coupon U.S. Treasury bonds) adjusted upward for the effect of the firm's credit standing. A liquid, solvent, relatively unleveraged firm—one with a strong credit standing—would have a smaller adjustment than a firm that is less creditworthy.

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non-cancelable lease term commencing on the date that it takes 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, DG 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. DG also receives tenant allowances, which it records as deferred incentive rent and amortizes as a reduction to rent expense over the term of the lease. DG reflects as a liability any difference between the calculated expense and 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.

Source: Dollar General Corporation, 2006 10-K, and author's calculations.

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Exhibit 6 Dollar General Ratios Analysis

	Fiscal years ended February 3,				
(amounts in thousands)	2007	2006	2005	2004	2003
Growth in revenues	6.8%	12.0%	11.5%	12.6%	
Effective tax rate	37.4%	35.7%	35.6%	37.3%	36.1%
EBITDA	$448,884	$748,691	$721,454	$662,483	$591,566
Enterprise value	5,421,575	5,413,733	6,437,583	7,098,829	3,828,633
Profitability ratios					
Profit margin	1.5%	4.1%	4.5%	4.4%	4.3%
Return on assets (ROA)	5.2%	12.4%	13.1%	12.9%	--
Return on equity (ROE)	8.0%	20.6%	21.3%	21.0%	--
Dividends payout	45.3%	16.0%	15.3%	15.7%	16.3%
Investment utilization					
Asset turnover	3.0	2.9	2.8	2.8	--
Working capital turnover	10.0	9.4	8.5	8.8	--
Asset intensity	19.3%	20.3%	20.4%	21.4%	--
Days' receivable	--	--	--	--	--
Inventory turnover	4.7	4.3	4.3	4.3	
Days' inventory	78.0	85.1	85.7	85.7	--
Days' payable	28.7	26.9	25.8	27.1	--
Solvency ratios					
Current ratio	2.1	2.1	2.1	2.2	2.0
Quick ratio	0.3	0.3	0.3	0.6	0.2
Debt-to-equity ratio	15.5%	16.2%	16.1%	18.1%	26.9%
Interest coverage	8.9	32.6	25.1	16.1	10.6
Market ratios					
Price / Earnings (P/E)	35.2	18.5	19.1	20.3	19.1
Dividend yield	1.3%	0.9%	0.8%	0.8%	0.9%
Market to book	3.1	3.1	3.8	4.7	2.8
Enterprise value / EBITDA	12.1	7.2	8.9	10.7	6.5
Other ratios					
Sales / Employees	$131.9	$133.1	$121.2	$118.9	$114.0
Net income / Employees	$2.0	$5.4	$5.4	$5.2	$4.9
Operating cash flow / Employees	$5.8	$8.6	$6.2	$8.9	$7.9
Advertising / Sales	0.5%	0.2%	0.1%	0.1%	0.1%
(Rent expense x 8) / Total assets [a]	90.5%	83.8%	75.7%	70.8%	69.6%
Capital expenditures / Net sales	2.9%	3.3%	3.8%	2.0%	2.2%
Depreciation & amortization / Net sales	2.2%	2.2%	2.1%	2.2%	2.3%

Definitions of ratios are on the following page.

[a] In order to "capitalize" operating leases and treat them as capital leases, many industry observers simply use eight times the current-year rental expense.

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Exhibit 6 (continued)

Definitions of ratios used:

EBITDA	Earnings before interest, taxes depreciation and amortization
Enterprise value	Market capitalization + net debt, where: Market capitalization = stock price x number of shares outstanding Net Debt = total debt - cash and cash equivalents - short term investments
Profitability Ratios	
Profit margin	Net earnings / Net sales
Return on assets (ROA)	(Net earnings + net interest x (1- tax rate)) / Total assets (average)
Return on equity (ROE)	Net earnings / Total stockholders' equity (average)
Dividends Payout	Cash dividends / Net earnings
Investment utilization	
Asset turnover	Net sales / Total assets (average)
Working capital turnover	Net sales / (Current assets (average) - current liabilities (average))
Asset intensity	(Current operating assets + PP&E - current and non-current operating liabilities (average)) / Net Sales
Days' receivable	Accounts receivable (average) x 365 / Net sales
Inventory turnover	COGS / Inventory (average)
Days' inventory	365 / Inventory turnover
Days' payable	Accounts payable (average) x 365 / (COGS + this year's inventory - last year's inventory)
Solvency ratios	
Current Ratio	Current assets / Current liabilities
Quick Ratio	(Cash + short term investments) / Current liabilities
Debt-to-equity ratio	Total Debt / Total shareholders' equity
Interest coverage	Income before interest and taxes / Net interest expense
Market ratios	
Price / Earnings ratio (P/E)	Average share price / Earnings per share
Dividend yield	Dividends per share / Stock price per share
Market to book	Market capitalization / Total stockholder' equity

Source: Dollar General Corporation, 2006 10-K, and author's calculations.

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Exhibit 7 Comparable Firms' Common-Size Income Statements and Other Key Financials

	Dollar General Year ended February 2,		Family Dollar Year ended August 26,		Fred's Inc Year ended February 3,		Dollar Tree Year ended February 3,		99 Cent Only Dec 31,	99 Cent Only March 3,
(amounts in millions)	2007	2006	2006	2005	2007	2006	2007	2006	2006	2006
Net sales	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	74.2	71.3	66.9	67.1	72.0	71.8	65.8	65.5	61.4	62.5
Gross profit	25.8	28.7	33.1	32.9	28.0	28.2	34.2	34.5	38.6	37.5
SG&A expense	23.1	22.2	28.2	27.1	25.7	25.7	26.4	26.2	38.2	36.3
Income from operations	2.7	6.5	5.0	5.8	2.3	2.5	7.8	8.4	0.3	1.1
Interest income	-0.1	-0.1	-0.1	-0.1	0.0	0.0	-0.2	-0.2	-0.7	-0.5
Interest expense	0.4	0.3	0.2	0.0	0.0	0.1	0.4	0.5	0.1	0.0
Income (loss) before income taxes	2.4	6.3	4.9	5.9	2.3	2.5	7.6	8.1	1.0	1.6
Income tax expense (benefit)	0.9	2.3	1.8	2.2	0.8	0.8	2.8	3.0	0.3	0.5
Net income (loss)	1.5	4.1	3.1	3.7	1.5	1.6	4.8	5.1	0.7	1.1
Net Sales	$9,169.8	$8,582.2	$6,394.8	$5,824.8	$1,767.2	$1,589.3	$3,969.4	$3,393.9	$1,080.9	$1,023.6
Growth in sales	6.8%	12.0%	9.8%	10.3%	11.2%	10.2%	17.0%	8.6%	5.6%	3.9%
Growth in same-store sales	3.3%	2.2%	3.7%	2.3%	2.4%	1.2%	4.6%	-0.8%	2.4%	0.3%
Effective tax rate	37.4%	35.7%	37.3%	36.5%	33.5%	33.5%	36.6%	36.8%	32.0%	31.8%
Depreciation and amortization	$200.6	$186.8	$134.6	$114.7	$29.1	$27.8	$159.0	$140.7	$32.6	$31.4
Capital Expenditures, net	259.9	282.7	190.4	227.1	26.4	27.8	175.3	139.2	43.9	47.6
Net cash provided by operating activities	$405.4	$555.5	$451.0	$299.4	$35.3	$48.5	$412.8	$365.1	$24.7	$82.5
EBITDA	$448.9	$748.7	$451.9	$453.5	$70.1	$67.8	$469.8	$424.6	$36.3	$43.1
Enterprise value	5421.6	5413.7	3535.2	3112.0	578.8	613.8	3125.3	2596.2	728.9	827.7
Enterprise value / EBITDA	12.1x	7.2x	7.8x	6.9x	8.3x	9.0x	6.7x	6.1x	20.1x	19.2x

Note: Family Dollar SG&A expense for the year 2006 includes litigation charge of $45 million.

Because 99 Cents Stores had not yet announced its fiscal year 2007 financial results, Sadayo calculated the last 12 months' results (LTM) for the period ended December 31, 2006.

Exhibit 7 (continued) Comparable Firms' Common-Size Balance Sheets

	Dollar General		Family Dollar		Fred's Inc		Dollar Tree		99 Cent Only	
	Year ended February 2,		Year ended August 26,		Year ended February 3,		Year ended February 3,		Dec 31,	March 3,
	2007	2006	2006	2005	2007	2006	2007	2006	2006	2006
Assets										
Current assets:										
Cash and cash equivalents	6.2%	6.7%	3.2%	4.4%	0.5%	0.6%	4.5%	3.7%	1.4%	0.8%
Short-term investments	1.0	0.3	5.4	1.4	--	--	11.8	15.2	18.9	18.7
Receivables	--	--	--	--	9.3	6.4	--	--	0.4	0.5
Merchandise inventories	47.1	49.5	41.1	45.3	59.1	61.0	32.3	32.1	22.9	22.3
Deferred income taxes	0.8	--	5.3	4.2	--	--	0.6	0.6	4.8	4.9
Other current assets	2.2	1.7	1.2	1.0	2.4	2.2	1.9	0.9	2.5	2.3
Total current assets	57.3	58.2	56.2	56.2	71.3	70.2	51.2	52.5	50.8	49.4
Property, plant and equipment, net	40.7	40.0	42.7	42.6	26.8	28.1	38.2	37.9	41.6	41.2
Intangibles, net	--	--	--	--	--	--	7.8	7.2	--	--
Other assets, net	2.0	1.8	1.1	1.1	1.9	1.7	2.8	2.4	7.6	9.4
Total assets	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Liabilities and stockholders' equity										
Current liabilities:										
Current portion of long-term debt	0.3%	0.3%	--	--	0.1%	0.2%	1.0%	1.1%	1.1%	0.01%
Accounts payable	18.3	17.1	22.1	23.9	12.5	15.8	10.1	7.5	4.4	6.1
Other current liabilities	8.3	8.1	17.0	13.1	8.2	6.3	7.0	5.5	11.4	11.2
Income taxes payable	0.5	1.5	--	0.2	0.8	1.2	2.3	2.3	--	--
Deferred income taxes	--	0.2	--	--	3.2	3.7	--	--	--	--
Total current liabilities	27.4	27.2	39.1	37.1	24.8	27.2	20.5	16.4	16.9	17.3
Long-term debt	8.6	9.1	9.9	--	0.5	1.4	13.3	13.9	0.1	1.1
Deferred income taxes	1.4	1.6	3.1	3.6	2.4	2.1	0.1	1.3	--	--
Other liabilities	5.2	4.4	--	--	0.7	1.1	3.8	3.2	1.9	1.8
Total liabilities	42.6	42.3	52.1	40.7	28.4	31.8	37.7	34.8	18.9	20.2
Shareholders' equity:										
Common Stock	5.1	5.3	0.7	0.8	--	--	0.1	0.1	--	--
Additional paid-in capital	16.0	15.5	5.6	5.6	26.3	26.9	--	0.6	34.7	34.3
Retained earnings	36.3	37.1	61.3	68.7	45.1	41.7	62.3	64.5	46.4	45.5
Common Stock held in treasury	--	--	-19.7	-15.7	--	--	--	--	--	--
Total stockholders' equity	57.4	57.7	47.9	59.3	71.6	68.2	62.3	65.2	81.1	79.8
Total liabilities and SH equity	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Total Assets (millions)	$3,040.5	$2,980.3	$2,523.0	$2,409.5	$515.7	$498.1	$1,873.3	$1,798.4	$639.7	$628.7

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Exhibit 7 (continued) Comparable Companies Ratios Analysis

	Dollar General Year ended February 2,		Family Dollar Year ended August 26,		Fred's Inc Year ended February 3,		Dollar Tree Year ended February 3,		99 Cent Only		Average of Four Companies	
									Dec 31,	March 3,		
(amounts in thousands)	2007	2006	2006	2005	2007	2006	2007	2006	2006	2006	2007	2006
Profitability Ratios												
Profit margin	1.5%	4.1%	3.1%	3.7%	1.5%	1.6%	4.8%	5.1%	0.7%	1.1%	2.5%	2.9%
Return on assets (ROA)	5.2%	12.4%	8.1%	9.3%	5.4%	5.5%	10.7%	10.0%	0.4%	1.3%	6.1%	6.5%
Return on equity (ROE)	8.0%	20.6%	14.8%	15.7%	7.5%	8.0%	16.4%	14.9%	1.5%	2.3%	10.1%	10.2%
Dividends payout	45.3%	16.0%	32.1%	27.6%	11.9%	12.2%	--	--	--	--	22.0%	19.9%
Investment utilization												
Asset turnover	3.0	2.9	2.6	2.5	3.5	3.3	2.2	1.9	1.7	1.7	2.5	2.3
Working capital turnover	10.0	9.4	14.3	12.3	7.8	7.6	6.5	5.1	5.2	5.3	8.4	7.6
Asset intensity	19.3%	20.3%	18.8%	20.3%	19.1%	20.6%	23.5%	28.8%	28.1%	28.2%	22.4%	24.5%
Days' receivable	--	--	--	--	8.2	7.2	--	--	0.9	1.4	4.6	4.3
Inventory turnover	4.7	4.3	4.0	3.8	4.2	3.9	4.4	3.7	4.6	4.7	4.3	4.0
Days' inventory	78.0	85.1	90.8	96.7	87.3	92.6	82.6	97.9	78.7	77.8	84.9	91.3
Days' payable	28.7	26.9	48.9	50.4	20.5	23.2	22.4	21.7	18.0	17.0	27.5	28.1
Solvency ratios												
Current Ratio	2.1	2.1	1.4	1.5	2.9	2.6	2.5	3.2	3.0	2.8	2.5	2.5
Quick Ratio	0.3	0.3	0.2	0.2	0.0	0.0	0.8	1.1	1.2	1.1	0.6	0.6
Debt-to-equity ratio	15.5%	16.2%	20.7%	0.0%	0.8%	2.3%	23.0%	22.9%	1.5%	1.4%	11.5%	6.7%
Interest coverage	8.9	32.6	51.5	-85.0	55.6	48.5	39.3	32.6	-0.5	-2.4	36.5	-1.6
Market ratios												
Price / Earnings (P/E)	35.2	18.5	18.9	21.6	19.6	23.9	15.4	15.3	108.0	67.4	40.5	32.1
Dividend yield	1.3%	0.9%	1.7%	1.3%	0.6%	0.5%	--	--	--	--	1.2%	0.9%
Market to book	3.1	3.1	2.9	2.3	1.6	1.8	2.7	2.3	1.6	1.9	2.2	2.1
Enterprise value / EBITDA	12.1	7.2	7.8	6.9	8.3	9.0	6.7	6.1	20.1	19.2	10.7	10.3
Other ratios												
Sales / Employees	$131.9	$133.1	$188.1	$176.5	$176.5	$153.3	$144.6	$139.1	$111.5	$105.6	$155.2	$143.6
Net income / Employees	$2.0	$5.4	$5.7	$6.6	$2.7	$2.5	$7.0	$7.1	$0.8	$1.2	$4.0	$4.4
Operating cash flow / Employees	$5.8	$8.6	$13.3	$9.1	$3.5	$4.7	$15.0	$15.0	$2.5	$8.5	$8.6	$9.3
Advertising / Sales	0.5%	0.2%	0.1%	0.1%	1.6%	1.4%	0.3%	0.3%	0.4%	0.4%	0.6%	0.6%
(Rent expense x 8) / Total assets	90.5%	83.8%	94.6%	92.7%	82.7%	77.7%	112.2%	100.8%	58.9%	58.2%	87.1%	82.3%
Capital expenditures / Net sales	2.9%	3.3%	3.0%	3.9%	1.5%	1.7%	4.4%	4.1%	4.1%	4.7%	3.2%	3.6%
Depreciation & amortization / Net sales	2.2%	2.2%	2.1%	2.0%	1.6%	1.7%	4.0%	4.1%	3.0%	3.1%	2.7%	2.7%

Source: Dollar General Corporation, 2006 10-K, and author's calculations.

Exhibit 8 Selected M&A Transactions in the Retail Industry

Announcement Date	Buyer (Private Equity Sponsor)	Seller	Transaction Value ($mil)	1-day stock price premium	1-week stock price premium	EBITDA ($mil)	Transaction Value / EBITDA
3/17/2005	Kohlberg Kravis Roberts & Co, Bain Capital and others	Toys "R" Us Inc	$6,005	17.0%	21.6%	$668.0	9.0x
11/8/2005	Apollo Management, Silver Point Capital Fund and others	Linens n Things Inc	$1,290	7.9%	14.9%	$140.0	9.2x
1/18/2006	Bain Capital Inc	Burlington Coat Factory	$2,037	2.1%	4.0%	$275.0	7.4x
1/22/2006	Leonard Green & Partners	Sports Authority Inc	$1,021	20.0%	26.0%	$146.0	7.0x
6/30/2006	Bain Capital LLC and Blackstone Group LP	Michaels Stores Inc	$6,046	29.6%	34.2%	$472.0	12.8x
7/14/2006	Leonard Green & Partners LP and Texas Pacific Group Inc	Petco Animal Supplies Inc	$1,658	49.1%	48.3%	$210.0	7.9x
10/25/2006	Madison Dearborn Partners LLC	Yankee Candle Co Inc	$1,724	21.0%	19.0%	$198.0	8.7x
Average			**$2,826**	**20.9%**	**24.0%**	**$301.3**	**8.9x**
3/11/2007	**Kohlberg Kravis Roberts & Co**	**Dollar General Corp**	**$7,334**	**31.1%**	**34.0%**	**$670.0**	**10.9x**

Source: Thomson Financial, SDC Database, Credit Suisse, Equity Research Report, March 12, 2007, and author's calculations.

EBITDA are earnings before interest, taxes, depreciation, and amortization.

Dollar General's EBITDA value of $670 million was calculated by Credit Suisse for the last 12 months (LTM) ended October 31, 2006, and excluded special items such as impairment expenses.

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Exhibit 9 Selected Excerpts from Dollar General Corporation, Schedule 14A, 2007

Interests of the Company's Directors and Executive Officers in the Merger

In considering the recommendation of the board of directors, you should be aware that our directors and executive officers may be considered to have interests in the merger that are different from, or in addition to, your interests as a shareholder. Such interests include (i) severance payments and benefits payable to executive officers upon termination of employment under a qualifying actual or constructive termination of employment pursuant to agreements previously entered into between the executive officers and Dollar General, (ii) the accelerated vesting and cashing out of certain equity, compensation and equity awards and the accelerated vesting and/or payment of deferred compensation arrangements for certain directors and officers and (iii) rights to continued indemnification and insurance coverage after the merger for acts or omissions occurring prior to the merger. In addition, a number of our executive officers may, prior to the closing of the merger, enter into new arrangements with Parent or the surviving corporation regarding employment with, or the right to purchase or participate in the equity of, the surviving corporation.

Pre-Existing Employment Agreements and Other Arrangements

If Mr. Perdue's [Dollar General's Chairman and CEO] employment were terminated other than for death, disability or cause, or by Mr. Perdue for good reason immediately following the completion of the merger, Mr. Perdue would be entitled to cash severance payments in the aggregate amount of approximately $6,798,000.

Equity Awards

At the effective time of the merger, all restricted stock units [restricted shares, and stock options] issued and outstanding under Dollar General equity incentive plans will become fully vested and will be cancelled and converted into the right to receive a cash payment equal to the number of restricted stock units [restricted shares, and stock options] multiplied by $22.00, without interest and less any applicable withholding taxes. The table below sets forth the number and aggregate value of restricted stock units [restricted shares, and stock options] held by the Named Executive Officers and directors as of March 29, 2007.[a]

Restricted Stock Units:	David A. Perdue, aggregate value of	$ 11,641,781
Restricted Shares:	David A. Perdue, aggregate value of	$ 694,012
Stock Options:	David A. Perdue, aggregate value of	$ 9,555,223

New Employment Arrangements

As of the date of this proxy statement, none of our executive officers has entered into any agreement, arrangement or understanding with KKR, Parent or Merger Sub or any of their respective affiliates regarding employment with, or the right to purchase or participate in the equity of, the surviving corporation. However, prior to the closing, some or all of our executive officers may discuss or enter into such arrangements and/or amendments to their existing agreements.

Source: Dollar General Corporation, Schedule 14A, 2007.

[a]Equity awards and compensations for other executive officers and directors can be found in schedule 14A, 2007.

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Exhibit 10 Dollar General Corporation's Board of Directors

David A. Perdue (57) has served as Dollar General's Chief Executive Officer (since April 2003) and Chairman of the Board (since June 2003). Mr. Perdue previously served as Chairman and Chief Executive Officer of Pillowtex Corporation, a producer and marketer of home textiles, from July 2002 through March 27, 2003. Pillowtex filed for bankruptcy in July 2003 after emerging from a previous bankruptcy in May 2002. Mr. Perdue served Reebok International Ltd. from September 1998 to July 2002 as President and Chief Executive Officer of the Reebok Brand (January 2001 to July 2002), Executive Vice President, Global Operating Units (October 1999 to January 2001) and Senior Vice President, Global Supply Chain (September 1998 to October 1999). Prior to Reebok, Mr. Perdue was Senior Vice President of Haggar, Inc. (1994 to September 1998). He gained additional international expertise while based in Hong Kong where he served from 1992 to 1994 as Senior Vice President of Asia Operations for Sara Lee Corporation. Earlier in his career, he spent 12 years in management consulting with Kurt Salmon Associates, an international management consulting firm. Mr. Perdue serves as a director of Alliant Energy Corporation.

David L. Beré (53) has served as Dollar General's President and Chief Operating Officer since December 2006. He served from December 2003 until June 2005 as Corporate Vice President of Ralcorp Holdings, Inc. and as President and Chief Executive Officer of Bakery Chef, Inc., a leading manufacturer of frozen bakery products that was acquired by Ralcorp Holdings in December 2003. From 1998 until the acquisition, Mr. Beré was the President and Chief Executive Officer of Bakery Chef, Inc., and also served on its Board of Directors. From 1996 to 1998, he served as President and Chief Executive Officer of McCain Foods USA, a manufacturer and marketer of frozen foods and subsidiary of McCain Foods Limited. From 1978 to 1995, Mr. Beré worked for The Quaker Oats Company; he served as President of the Breakfast Division from 1992 to 1995 and President of the Golden Grain Division from 1990 to 1992.

Dennis C. Bottorff (62) has served as Chairman of Council Ventures, LLC, an investment firm, since January 2001. He previously served as Chairman of AmSouth Bancorporation, a bank holding company, and prior to that as Chief Executive Officer (1991-1999) and Chairman (1995-1999) of First American Corporation. Mr. Bottorff is a director of Ingram Industries, Appforge, and Benefit Informatics, Inc., all privately held entities, and serves on the Board of Trustees of Vanderbilt University. He also serves as Chairman of the Tennessee Education Lottery Corp. and as a director of the Tennessee Valley Authority.

Barbara L. Bowles (59) has served as Vice Chairman of Profit Investment Management, a registered investment advisor, since January 2006. Previously, she served as Chairman and Chief Executive Officer of The Kenwood Group, Inc., a registered investment advisor that she founded in 1989, until its acquisition by Profit in January 2006. The Kenwood Group now operates as a subsidiary of Profit and Ms. Bowles continues to serve as its Chairman. She served as Vice President, Investor Relations of Kraft, Inc. from 1984 to 1989. Ms. Bowles is a director and audit committee member of Black & Decker Corporation, Wisconsin Energy Corporation (and Wisconsin Electric Power Company and Wisconsin Gas LLC, each a publicly-held subsidiary of Wisconsin Energy). Because we consider her service on the audit committees of Wisconsin Energy Corporation's family of companies to be service to one company due to the commonality of issues considered by those committees, the Board has determined that Ms. Bowles' service on more than 3 total public company audit committees does not impair her ability to effectively serve on our Audit Committee.

Reginald D. Dickson (60) has served as Chairman (since 1996) and Chief Executive Officer (since 2001) of Buford, Dickson, Harper & Sparrow, Inc., registered investment advisors. Mr. Dickson served as President and Chief Executive Officer of Inroads, Inc., a non-profit organization supporting

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minority education, from 1983 to 1993, and was subsequently granted the honorary title of President Emeritus.

E. Gordon Gee (60) has served as Chancellor of Vanderbilt University since 2000. He previously served as President of Brown University from 1998 until 2000, and as President of The Ohio State University from 1990 until 1998. Dr. Gee is a director of The Limited, Inc., Hasbro, Inc., Massey Energy, Inc., and Gaylord Entertainment Company.

Barbara M. Knuckles (59) has served as Managing Director of Development and Corporate Relations (since January 2006) and as Director of Development and Corporate Relations (1992-2006) for North Central College in Naperville, Illinois. From 1988 to 1992, Ms. Knuckles was a private investor managing several family businesses. Ms. Knuckles also served as a Corporate Vice President for Beatrice Foods, Inc. (1978-1986) and for The Wirthlin Group (1986-1988).

J. Neal Purcell (65) served as the Southeast Area Managing Partner of KPMG from July 1993 to October 1998 and as the Vice Chairman in charge of National Audit Practice Operations from October 1998 until his retirement on January 31, 2002. Mr. Purcell is a director (and chairman of the audit committee) of Southern Company and Synovus Financial Corporation as well as of Kaiser Permanente Health Care and Hospitals, a non-public entity. Mr. Purcell, whom our Board has determined to be independent as defined in NYSE listing requirements and in our Corporate Governance Principles, has been designated an audit committee financial expert.

James D. Robbins (60) served as Managing Partner of the Columbus, Ohio office of PricewaterhouseCoopers L.L.P. from 1993 until his retirement in 2001. Mr. Robbins is a director (and chairman of the audit committee) of Huntington Preferred Capital, Inc. and DSW Inc. Mr. Robbins, whom our Board has determined to be independent as defined in NYSE listing requirements and in our Corporate Governance Principles, has been designated an audit committee financial expert.

Richard E. Thornburgh (54) is Vice Chairman of Corsair Capital, a private equity investment company, and serves on the board and the risk committee of Credit Suisse Group, a diversified financial services holding company. He began his career at The First Boston Corporation, a predecessor to Credit Suisse First Boston, and served in a number of Credit Suisse executive positions over three decades, including CFO and Chief Risk Officer of Credit Suisse Group, CFO of Credit Suisse First Boston and, most recently, Executive Vice Chairman of CSFB and member of the executive board of Credit Suisse Group. Mr. Thornburgh serves as a director of NewStar Financial, Inc. He also formerly served as Chairman of the Securities Industry Association.

David M. Wilds (66) has served as Managing Partner of 1st Avenue Partners, L.P., a private equity partnership, and as a senior advisor for The Family Office, a limited liability company, since 1998. From 1995 to 1998, he was President of Nelson Capital Partners III, L.P., a merchant banking company. From 1990 to 1995, he served as Chairman of Cumberland Health Systems, Inc., an owner and operator of psychiatric hospitals, and he currently serves as a director of Symbion Inc. Mr. Wilds, whom our Board has determined to be independent as defined in NYSE listing requirements and in our Corporate Governance Principles, has been elected to serve as our Presiding Director, in which capacity he presides over the executive sessions of the Board's non-management and independent directors and performs other duties as set forth in our Corporate Governance Principles.

Source: Dollar General Corporation's 2006 10-K.

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