Annual Report
for the Year Ended
February 3, 2006

DOLLAR GENERAL

At Dollar General, the action is non-stop. On the move with 8,000 stores, eight around-the-clock distribution facilities and a bustling sourcing office in Hong Kong, Dollar General is hard at work for our customers—literally 24-7. We are passionate about Serving Others, completely committed to success and doing what it takes to achieve it.

About Dollar Ge

The largest small-box value discount retailer in the U.S., Dollar General delivers products that are used and replenished often by consumers, such as food, snacks, health and beauty aids and cleaning supplies, as well as basic apparel, housewares and seasonal items. The Company's 64,500 employees are guided by Dollar General's mission: "Serving Others – for customers, a better life; for shareholders, a superior return; for employees, respect and opportunity."

Our Supply Chain – Dollar Genera
nation. To support its prolific growth
networks in the retail industry. The c
in 2005. A ninth facility is expected t

Our Stores *– Dollar General operates neighborhood stores in communities often neglected or overlooked by national big-box retailers. Small by choice and convenient by design, Dollar General is the answer for today's busy, value-conscious shopper. In its second full year of operation, the Dollar General Market continues to march forward, growing to 44 stores by the end of 2005. The Dollar General Markets offer one-stop shopping for general merchandise and groceries, including fresh produce.*

Our Customers *– Dollar General caters to under-served customers, whose options are limited by time, money and access.*

Our Merchandise *– Dollar General delivers everyday low prices on national brands our customers know and trust, such as Tide, Pepsi, Mattel and Fisher-Price. In fact, Dollar General is among the top 10 customers of some of the nation's largest consumer products companies.*

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Dollar General issued its initial public stock offering in 1968, and today, its shares trade on the New York Stock Exchange under the symbol DG. The company was added to the S&P 500® in 1998 and was first listed on the Fortune 500® in 1999.

ral operates more company-owned stores than any retailer in the th, Dollar General invests in one of the most efficient distribution e company opened its eighth distribution center in Jonesville, S.C., l to open in 2006.

8,000 stores

(as of March 3, 2006)

Financial Highlights

(In millions, except per share and operating data)

	February 3, 2006 (a)	January 28, 2005	January 30, 2004	January 31, 2003	February 1, 2002
SUMMARY OF OPERATIONS:					
Net sales	**$ 8,582**	$ 7,661	$ 6,872	$ 6,100	$ 5,323
Net income	**$ 350**	$ 344	$ 299	$ 262	$ 204
PER SHARE RESULTS:					
Basic earnings per share	**$ 1.09**	$ 1.04	$ 0.89	$ 0.79	$ 0.61
Diluted earnings per share	**$ 1.08**	$ 1.04	$ 0.89	$ 0.78	$ 0.61
Cash dividends per share of common stock	**$ 0.175**	$ 0.160	$ 0.140	$ 0.128	$ 0.128
FINANCIAL POSITION:					
Total assets	**$ 2,992**	$ 2,841	$ 2,621	$ 2,304	$ 2,526
Long-term obligations	**$ 270**	$ 258	$ 265	$ 330	$ 339
Shareholders' equity	**$ 1,721**	$ 1,684	$ 1,554	$ 1,267	$ 1,024
OPERATING DATA:					
Retail stores at end of period	**7,929**	7,320	6,700	6,113	5,540

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

Fellow Shareholder:

For Dollar General, 2005 proved to be a year of significant accomplishments in positioning the Company to meet its long-term objectives. While it was a difficult year for the Company in some respects, we remain on target with regard to our strategic plan.

In 2005, we saw the organization grow and become stronger and more competitive. We added management expertise, drawing both from inside and outside the Company. We experienced the initial successes of our EZstore efforts and Project Gold Standard and learned how to make these projects even more effective. In March 2006, we celebrated the opening of our 8,000th store, strengthening our claim as the leader in our sector and the operator of more stores than any other retailer in the US.

Some of our other accomplishments for the year (a 53-week fiscal year) include:

- *We added $921 million of new revenue, growing net sales by 12 percent to $8.6 billion, while same-store sales increased 2.0 percent.*
- *We produced $350 million of net income, or 4.1 percent of net sales. Earnings per share were $1.08, up 3.8 percent over 2004.*
- *We generated $251 million in free cash flow.* We increased our per share dividend by over nine percent and paid cash dividends to shareholders of $56 million, or 17.5 cents per share. We repurchased approximately 15 million shares of our outstanding common stock.*
- *Standard and Poor's raised the Company's credit rating to investment grade.*
- *We opened 734 new stores, including 29 new Dollar General Markets. By fiscal year-end, we operated 7,929 stores in 31 states, including 44 Dollar General Markets.*
- *We opened our eighth distribution center in South Carolina in June 2005 and began construction on our ninth distribution center in Marion, Indiana.*
- *By fiscal year-end, 3,825 stores were operating as EZstores, using our newly engineered processes to run more effectively and efficiently.*

We saw our efforts during 2003 and 2004 begin to pay off nicely during the first three quarters of 2005. Illustrating that success: through three quarters, the Company posted same-store sales growth of 3.4 percent, which compared very favorably with our competitors. However, in the fourth quarter, our everyday low price model did not perform well against the heightened holiday promotional activity of other retailers. Same-store sales dropped by 1.6 percent in the fourth quarter.

I believe that the poor performance in the fourth quarter was a short-term misstep resulting from a number of factors rather than a sign of long-term weakness in our basic operating model. First, we believe the external economic environment, particularly higher fuel costs, unemployment and consumer debt, negatively impacted our consumers, forcing trip consolidation and deferred discretionary spending. We know the period was difficult for all retailers serving the lower income customer, and the intensified promotional

Left to right: ***Beryl J. Buley,*** *division president of merchandising, marketing and supply chain;* ***Challis M. Lowe,*** *executive vice president of human resources;* ***Kathleen R. Guion,*** *division president of store operations and store development;* ***David A. Perdue,*** *chairman and CEO;* ***Susan S. Lanigan,*** *executive vice president and general counsel;* ***David M. Tehle,*** *executive vice president and CFO.*

* *Please see "Non-GAAP disclosures" contained in Management's Discussion and Analysis of Financial Condition and Results of Operations on page 29.*

activity of our competitors seemed to be an attempt to combat what was an overall weakness in the sector.

Secondly, in addition to external pressures, we recognized that weaknesses in our operations also contributed to our fourth quarter results. After much analysis, we identified several internal issues that negatively impacted our results, and we moved quickly to improve our effectiveness in these areas. We firmly believe that we now have the people and plans in place to make those improvements and to meet the challenges we face, in both the short and long term.

Strategic Efforts

Three years ago during my first year with the Company, working with your board of directors, we established a strategic plan that included three major priorities. First, we decided to address the operation of our stores. We wanted to improve how we operated our stores and address several negative trends. Secondly, we knew that to compete in the changing retail environment, we had to strengthen our organization and prepare it for new challenges. Third, we had to improve our merchandising productivity and make our practices more contemporary to compete in a changing economic environment.

Strengthening Store Operations

To address the critical issues impacting the operation of our stores and, thus, our customers' experiences in the stores, we stepped back and performed a "soup-to-nuts" analysis of how our stores worked. In 2004, that comprehensive evaluation yielded an initiative we call "EZstore." While EZstore does not make working in a Dollar General store easy, it does make it less difficult and more productive. EZstore reduces physical labor for our employees, reduces labor costs for the Company, reduces potential damages, reduces accidents and their costs and, most importantly, improves the shopping experience for our customers. At the end of 2005, nearly half of our stores were EZstores. We will continue implementing the concept in other stores in 2006.

We employ approximately 64,500 people worldwide, and most of them work in our stores. These women and men are absolutely critical to our continued growth and success. In addition to the improvements realized from EZstore, we support our people by recruiting the right managers and by providing comprehensive training to new store managers on every aspect of running a Dollar General store. In 2005, we made additional progress toward our goal of promoting from within the Company. Of our 197 new district managers in 2005, 63 percent were promotions from within the Company. We also remain committed to diversity. By making our workforce an accurate reflection of our customer base, we more effectively meet diverse customers' needs.

Enhancing the Leadership Team

To successfully address our challenges and opportunities, we must have a strong, committed management team with the right talent, skill set and resources. That team also must operate with the highest level of integrity. Since joining the Company, I have continued to assess our needs in that regard and have worked to build the right team of people within the proper organizational structure. To help me with this, in 2005, we brought in a seasoned executive to lead our human resources function.

Improving the shopability of our stores is one way Dollar General caters to shoppers. Proper merchandising helps customers find key items faster. Senior Vice President of Store Operations Tom Mitchell shares merchandising tips with District Manager Lisa Buckley.

Dollar General began accepting electronic benefits transfer cards in 2003, making shopping hassle-free for customers on government assistance. At the same time, we make shopping for all customers more convenient by accepting debit cards and Discover Network cards.

Stores on the move.

Merchandising on the move.

In 2005, we added significant leadership talent in the areas of store operations and store development. All of the new additions have extensive and successful retail experience. We also put both of those areas under the same division president, ensuring that they work closely together to achieve their complementary goals.

Near the end of the 2005 fiscal year, we also combined our merchandising, marketing and supply chain teams under a new division president. This move was the final step in joining all of our merchandise-related efforts together to support sales growth in our stores. Under the new structure, we plan to bring in additional talent to take our merchandising efforts to the next level.

Refining Merchandising Strategies

The Dollar General model has succeeded because we have consistently offered merchandise from major national brands, as well as our own high quality private label products, at everyday low prices. Customers can find nearly every consumable need in our stores in addition to a selection of apparel, home and seasonal items. Customers can also purchase basic refrigerated and frozen foods, including dairy products, eggs and packaged convenience food items in most of our stores. In nearly all of our stores, we now have the ability to process electronic benefits transfer (EBT) cards, assisting many customers who rely on government assistance.

During 2006, we plan to focus on long-term improvement of our merchandising function. Specifically, we are just starting our category management effort and will continue to enhance our segmentation capabilities. We are also working to strengthen our planogram, making it more responsive to trends in the market.

In 2006, we plan to increase our branded assortment and ensure the proper presentation of national brands. At the same time, we have the opportunity to improve our private label assortment and increase its share of our mix. We are improving our sourcing capabilities, as well as our ability to find special purchases that will enhance our treasure hunt dimension. Our pricing continues to be very competitive, and in 2005 we initiated a much more rigorous national benchmarking effort to ensure that we remain extremely competitive on price. We also have developed a new store prototype that we plan to test in existing stores and roll out in our new stores in 2006.

Space in our existing stores is being reallocated both to highlight categories that we know are important to our customers and to add new products. We also are positioning ourselves to respond more quickly to changes in customer needs and product trends throughout the year.

We demand quality products with the right prices from our vendors, and we value our relationships with vendors who meet that demand. We will continue to develop these strong vendor relationships and to build new ones. As part of that effort, we are planning several projects with key vendors in 2006 to enhance the profile of their brands in our stores.

Vice President of Global Sourcing Monique Wong leads the Dollar General Hong Kong buying team. Using trend forecasts and sharp negotiating skills, the team secures products customers want at prices they can afford.

Stock car racing remains one of the fastest-growing spectator sports in the U.S. and a popular pastime for many of our core customers. Dollar General enters its second year as a NASCAR race team sponsor with rising star Burney Lamar at the wheel.

In 2001, we were the first "dollar store" to introduce coolers, making basic foods, like milk, eggs and cheese, more convenient for our customers.

Distribution on the move.

Dollar General's growing network of stores demands a high efficiency supply chain operation. Senior Vice President/General Merchandise Manager of Consumables Rita F. Branham, Vice President of Distribution Anthony Roden and Vice President of Process Improvement Rod West collaborate to ensure seamless movement of products from shop floor to sales floor.

Our Focus in 2006

In addition to driving toward the long-term strategic objectives outlined above, we will pay very close attention to the challenges ahead in 2006.

One of our highest priorities is improving same-store sales. That improvement requires effort in all areas of the business but will be chiefly centered in our merchandising, marketing and store operations functions.

To meet the expanding needs of our customers, as well as the growing number of new customers, we must grow as well. In 2006, we plan to open approximately 800 new traditional Dollar General stores and 30 Dollar General Markets. We expect to open our ninth distribution center in 2006 in Marion, Ind., and we will consider our expansion strategy as we determine the location of future distribution centers. We also will maintain our practice of investing in technology that supports our growth and helps improve performance.

Since its founding in 1939, Dollar General has cultivated a strong and loyal customer base. Its customer-centered efforts have endured and succeeded through various economic cycles. The Company's compounded annual sales growth rate is in excess of 17 percent over the past 10 years. Our legacy of being "customer-centric" is crucial to our future success.

Past leaders of the Company, including our founder J.L. Turner, his son Cal Turner, Sr., and his grandson Cal Turner, Jr., understood the importance of focusing on the customer. They personalized the effort to help our customers deal with the financial pressures of everyday life.

Today, we build on that legacy. As we continue to add new customers, we never forget the needs of our low-income core customer. Our ability to understand the circumstances our customers face and to give them products they want, at prices they can afford, is our greatest strength, and our customers know it.

The supply chain team is critical to the success of the EZstore process improvement program, which continues to show promising preliminary results.

Store Development on the move.

Our customers tell us they are proud of how far they can stretch their income and that they appreciate Dollar General's efforts to help them in that regard. We do not take that responsibility lightly.

Although Dollar General is the oldest and largest player in our sector, we are still growing rapidly. Our business model is as relevant as ever, and we are focused on ensuring that it remains competitive. We have a significant opportunity to increase our number of stores. In addition, we believe we also can grow by increasing the productivity of our existing stores by adapting to the ever-changing economic pressures and needs of our customers.

Your management team, with your board of directors, is working diligently on your behalf to grow shareholder value. We are excited about our future prospects and are motivated and energized to achieve our objectives, including consistent financial growth. You have a capable team, and I am extremely proud of our progress.

I am very grateful to have the opportunity to lead Dollar General at this crucial time in its history. I believe we understand the issues before us and have the people who can deal with them. We understand the needs of our customers and our employees, and we endeavor to balance those

Senior Vice President of Real Estate and Store Development Gayle Aertker and her store-set team celebrate another major milestone – the grand opening of Dollar General's 8,000th store on March 3, 2006.

with our responsibility to you, our shareholders.

Thank you for your investment in Dollar General Corporation and your continued support.

David A. Perdue
Chairman and Chief Executive Officer
April 2006

The first Dollar General Market opened in 2003. Perishables – fruits, vegetables, and basic cuts of meat – are now a part of our strategy to deliver life's necessities at value prices in convenient locations to our customers.

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SELECTED FINANCIAL DATA

The following table sets forth selected consolidated financial information for each of the five most recent fiscal years. This information should be read in conjunction with the Consolidated Financial Statements and the notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations.

(In thousands, except per share and operating data)	February 3, 2006(a)	January 28, 2005	January 30, 2004	January 31, 2003	February 1, 2002
Summary of Operations:					
Net sales	**$ 8,582,237**	$ 7,660,927	$ 6,871,992	$ 6,100,404	$ 5,322,895
Gross profit	**$ 2,464,824**	$ 2,263,192	$ 2,018,129	$ 1,724,266	$ 1,509,412
Penalty expense and litigation settlement (proceeds)	**$ –**	$ –	$ 10,000	$ (29,541)	$ –
Income before income taxes	**$ 544,642**	$ 534,757	$ 476,523	$ 410,337	$ 322,174
Net income	**$ 350,155**	$ 344,190	$ 299,002	$ 262,351	$ 203,874
Net income as a % of sales	**4.1%**	4.5%	4.4%	4.3%	3.8%
Per Share Results:					
Basic earnings per share	**$ 1.09**	$ 1.04	$ 0.89	$ 0.79	$ 0.61
Diluted earnings per share	**$ 1.08**	$ 1.04	$ 0.89	$ 0.78	$ 0.61
Cash dividends per share of common stock	**$ 0.175**	$ 0.160	$ 0.140	$ 0.128	$ 0.128
Weighted average diluted shares	**324,133**	332,068	337,636	335,050	335,017
Financial Position:					
Total assets	**$ 2,992,187**	$ 2,841,004	$ 2,621,117	$ 2,303,619	$ 2,526,481
Long-term obligations	**$ 269,962**	$ 258,462	$ 265,337	$ 330,337	$ 339,470
Shareholders' equity	**$ 1,720,795**	$ 1,684,465	$ 1,554,299	$ 1,267,445	$ 1,023,690
Return on average assets (b)	**12.1%**	12.7%	12.3%	10.9%	8.6%
Return on average equity (b)	**20.9%**	22.1%	21.4%	23.2%	22.2%
Operating Data:					
Retail stores at end of period	**7,929**	7,320	6,700	6,113	5,540
Year-end selling square feet	**54,753,000**	50,015,000	45,354,000	41,201,000	37,421,000
Highly consumable sales	**65.3%**	63.0%	61.2%	60.2%	58.0%
Seasonal sales	**15.7%**	16.5%	16.8%	16.3%	16.7%
Home products sales	**10.6%**	11.5%	12.5%	13.3%	14.4%
Basic clothing sales	**8.4%**	9.0%	9.5%	10.2%	10.9%

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

(b) Average assets or equity, as applicable, is calculated using the fiscal year-end balance and the four preceding fiscal quarter-end balances.

Except for specific historical information, many of the discussions in this report may express or imply projections of revenues or expenditures, plans and objectives for future operations, growth or initiatives, expected future economic performance, or the expected outcome or impact of pending or threatened litigation. These and similar statements regarding events or results which Dollar General Corporation (the "Company" or "Dollar General") expects will or may occur in the future are forward-looking statements concerning matters that involve risks, uncertainties and other factors which may cause the actual performance of the Company to differ materially from those expressed or implied by these statements. All forward-looking information should be evaluated in the context of these risks, uncertainties and other factors. The words "believe," "anticipate," "project," "plan," "expect," "estimate," "objective," "forecast," "goal," "intend," "will likely result," or "will continue" and similar expressions generally identify forward-looking statements. The Company believes the assumptions underlying these forward-looking statements are reasonable; however, any of the assumptions could be inaccurate, and therefore, actual results may differ materially from those projected in or implied by the forward-looking statements. Factors and risks that may result in actual results differing from this forward-looking information include, but are not limited to, those listed below, as well as other factors discussed throughout this document, including, without limitation, the factors described under "Critical Accounting Policies and Estimates" in Management's Discussion and Analysis contained herein, or discussed, from time to time, in the Company's filings with the Securities and Exchange Commission (the "SEC"), press releases and other communications.

Readers are cautioned not to place undue reliance on forward-looking statements made in this document, since the statements speak only as of the document's date. The Company has no obligation, and does not intend, to publicly update or revise any of these forward-looking statements to reflect events or circumstances occurring after the date of this document or to reflect the occurrence of unanticipated events. Readers are advised, however, to consult any further disclosures the Company may make on related subjects in its documents filed with or furnished to the SEC or in its other public disclosures.

The Company's business is moderately seasonal with the highest portion of sales occurring during the fourth quarter. Adverse events during the fourth quarter could, therefore, materially affect the Company's financial statements as a whole. The Company realizes a significant portion of its net sales and net income during the Christmas selling season in the fourth quarter. In anticipation of this holiday, the Company purchases substantial amounts of seasonal inventory and hires many temporary employees. A seasonal merchandise inventory imbalance could result if for any reason the Company's net sales during the Christmas selling season were to fall below seasonal norms. If such an imbalance were to occur, more markdowns than anticipated might be required to minimize the imbalance. The Company's profitability and operating results could be adversely affected by unanticipated markdowns and by lower than anticipated sales. Lower than anticipated sales in the Christmas selling season would also negatively impact the Company's ability to leverage the increased labor costs.

Competition in the retail industry could limit the Company's growth opportunities and reduce its profitability. The Company operates in the discount retail merchandise business, which is highly competitive. This competitive environment subjects the Company to the risk of reduced profitability because of the lower prices, and thus the lower margins, required to maintain the Company's competitive position. The Company competes 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 the Company operates. The Company's direct competitors in the dollar store retail category include, without limitation, Family Dollar, Dollar Tree, Fred's, and various local, independent operators. Competitors from other retail categories include Wal-Mart and Walgreens, among others. Some of the Company's competitors utilize aggressive promotional activities, advertising programs, and pricing discounts and the Company's results of operations could be adversely affected if the Company does not respond effectively to these efforts.

The discount retail merchandise business is subject to excess capacity, and some of the Company's competitors are much larger and have substantially greater resources than the Company. The competition for customers has intensified in recent years as larger competitors, such as Wal-Mart, have moved into, or increased their presence in, the Company's geographic markets. The Company remains vulnerable to the marketing power and high level of consumer recognition of these major national discount chains and to the risk that these chains or others could venture into the "dollar store" industry in a significant way. Generally, the Company expects an increase in competition.

The Company's financial performance is highly sensitive to changes in overall economic conditions that may impact consumer spending and the Company's costs of doing business. A general slowdown in the United States economy or rising personal debt levels may adversely affect the spending of the Company's consumers, which would likely result in lower net sales than expected on a quarterly or annual basis. Economic conditions affecting disposable consumer income, such as employment levels, business conditions, fuel and energy costs, inflation, interest rates, and tax rates, could also adversely affect the Company's business by reducing consumer spending or causing consumers to shift their spending to other products. The Company might be unable to anticipate these buying patterns and implement appropriate inventory strategies, which would adversely affect its sales and gross profit performance. In addition, continued increases in fuel and energy costs would increase the Company's transportation costs and overall cost of doing business and could adversely affect the Company's financial statements as a whole.

Natural disasters or unusually adverse weather conditions could adversely affect the Company's net sales and supply chain efficiency. Unusually adverse weather conditions, natural disasters or similar disruptions, especially during the peak Christmas selling season, but also at other times, could significantly reduce the Company's net sales. In addition, these disruptions could also adversely affect the Company's supply chain efficiency and make it more difficult for the Company to obtain sufficient quantities of merchandise from its suppliers.

Existing military efforts and the possibility of war and acts of terrorism could disrupt the Company's information or distribution systems or increase our costs of doing business. Existing U.S. military efforts, as well as the involvement of the United States in other military engagements, or a significant act of terrorism on U.S. soil or elsewhere, could have an adverse impact on the Company by, among other things, disrupting its information or distribution systems; causing dramatic increases in fuel prices thereby increasing the costs of doing business; or impeding the flow of imports or domestic products to the Company.

The Company's business is dependent on its ability to obtain attractive pricing and other terms from its vendors. The Company believes that it has generally good relations with its vendors and that it is generally able to obtain attractive pricing and other terms from vendors. However, if the Company fails to maintain good relations with its vendors, it may not be able to obtain attractive pricing with the consequence that its net sales or profit margins would be reduced. Also, prolonged or repeated price increases of certain raw materials could affect our vendors' product costs and, ultimately, the Company's profitability. The Company's ability to pass on incremental pricing changes may be limited due to operational and competitive factors, which could negatively affect the Company's profitability and sales.

The efficient operation of the Company's business is heavily dependent on its information systems. The Company depends on a variety of information technology systems for the efficient functioning of its business. The Company relies on certain software vendors to maintain and periodically upgrade many of these systems so that they can continue to support the Company's business. The software programs supporting many of the Company's systems were licensed to the Company by independent software developers. The inability of these developers or the Company to continue to maintain and upgrade these information systems and software programs would disrupt or reduce the efficiency of the Company's operations if it 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 the Company's operations. The Company also relies heavily on its information technology staff. If the Company cannot meet its staffing needs in this area, the Company may not be able to fulfill its technology initiatives while continuing to provide maintenance on existing systems.

The Company is dependent upon the smooth functioning of its distribution network, the capacity of its distribution centers ("DCs"), and the timely receipt of inventory. The Company relies upon the ability to replenish depleted inventory through deliveries to its DCs from vendors and from the DCs to its stores by various means of transportation, including shipments by air, sea and truck. Labor shortages in the transportation industry could negatively affect transportation costs. In addition, long-term disruptions to the national and international transportation infrastructure that lead to delays or interruptions of service would adversely affect the Company's business. The Company also may face difficulty in obtaining needed inventory from its vendors because of interruptions in production, adverse weather conditions, foreign trade restrictions or government regulations, or for other reasons, which would adversely affect the Company's sales. Moreover, if the

Company were unable to achieve functionality of new DCs in the time frame expected, the Company's ability to achieve the expected growth could be inhibited.

Construction and expansion projects relating to the Company's DCs entail risks which could cause delays and cost overruns, such as: shortages of materials; shortages of skilled labor or work stoppages; unforeseen construction, scheduling, engineering, environmental or geological problems; weather interference; fires or other casualty losses; and unanticipated cost increases. The completion dates and ultimate costs of these projects could differ significantly from initial expectations due to construction-related or other reasons. The Company cannot guarantee that any project will be completed on time or within established budgets.

The Company's success depends to a significant extent upon the abilities of its senior management team and the performance of its employees. The loss of services of key members of the Company's senior management team or of certain other key employees could negatively affect the Company's business. The risk of key employee turnover intensifies as a greater number of public corporations locate in the vicinity of the Company's headquarters. In addition, future performance will depend upon the Company's ability to attract, retain and motivate qualified employees to keep pace with its expansion schedule. The inability to do so may limit the Company's ability to effectively penetrate new market areas. Also, the Company's stores are decentralized and are managed through a network of geographically dispersed management personnel. The inability of the Company to effectively and efficiently operate its stores, including the ability to control losses resulting from inventory and cash shrinkage, may negatively impact the Company's sales and/or operating margins.

If the Company cannot open new stores on schedule, its growth will be impeded which would adversely affect sales. The Company's growth is dependent on both increases in sales in existing stores and the ability to open new stores. Delays in store openings could adversely affect the Company's future operations by slowing new store growth, which may in turn reduce its revenue growth. The Company's 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 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. Many of these factors are beyond the Company's control. In addition, the Company may not anticipate all of the challenges imposed by the expansion of its operations and, as a result, may not meet its targets for opening new stores or expanding profitably.

The inability to execute operating initiatives could negatively affect the Company's future operating results. The Company is involved in a significant number of operating initiatives that have the potential to be disruptive in the short term if they are not implemented effectively. Ineffective implementation or execution of some or all of these initiatives could also negatively impact the Company's operating results. Please reference the discussion of the initiatives in the "Results of Operations – Executive Overview" section included in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of this document.

The Company's cost of doing business could increase as a result of changes in federal, state or local regulations. Unanticipated changes in the federal or state minimum wage or living wage requirements or changes in other wage or workplace regulations could adversely affect the Company's ability to meet financial targets. In addition, changes in federal, state or local regulations governing the sale of the Company's products, particularly "over-the-counter" medications or health products, could increase the Company's cost of doing business and could adversely affect the Company's sales results. Also, the Company's inability to comply with these regulatory changes in a timely fashion or to adequately execute a required recall could result in significant fines or penalties that could affect the Company's financial statements as a whole.

Unanticipated increases in insurance costs or loss experience could negatively impact profitability. The costs of some insurance (workers' compensation insurance, general liability insurance, health insurance and property insurance) and loss experience have risen in recent years. Higher than expected increases in these costs or other insurance costs or unexpected escalations in the Company's loss rates could have an unanticipated negative impact on the Company's profitability.

The Company is subject to certain legal proceedings that may adversely affect its financial statements as a whole. The Company is involved in a number of legal proceedings,

which include, for instance, consumer, employment, tort and other litigation. 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 statements as a whole or may negatively impact the Company's operating results if changes to the operation of the business are required. Please see Note 7 to the Consolidated Financial Statements included in this document for further details regarding certain of these pending matters.

The Company may be unable to rely on liability indemnities given by foreign vendors which could adversely affect its financial statements as a whole. The Company imports approximately 13% of its merchandise globally. Sources of supply may prove to be unreliable, or the quality of the globally sourced products may vary from the Company's expectations. The Company's ability to obtain indemnification from the manufacturers of these products may be hindered by the manufacturers' lack of understanding of U.S. product liability laws, which may make it more likely that the Company may have to respond to claims or complaints from its customers as if the Company were the manufacturer of the products. Any of these circumstances could have a material adverse effect on the Company's business and its financial statements as a whole.

The Company is subject to interest rate risk which could impact profitability. The Company is subject to market risk from exposure to changes in interest rates based on its financing, investing and cash management activities. Changes in interest rates could have an unanticipated negative impact on the Company's profitability.

General

Accounting Periods. The following text contains references to years 2006, 2005, 2004 and 2003, which represent fiscal years ending or ended February 2, 2007, February 3, 2006, January 28, 2005, and January 30, 2004, respectively. Fiscal year 2006 will be, and each of 2004 and 2003 was, a 52-week accounting period, 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. The Company's fiscal year ends on the Friday closest to January 31. 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 disclosure set forth above.

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.

Executive Overview

Dollar General Corporation ("Dollar General" or the "Company") is the largest dollar store discount retailer of consumable basics in the United States, with over 8,000 stores. We are committed to serving the needs of low-, middle- and fixed-income customers. However, the Company sells quality private label and national brand products that appeal to a wide range of customers. Our merchandise is priced at competitive everyday low prices that do not change frequently as a result of promotional activity. We believe many of our customers shop at Dollar General because they trust us to consistently stock quality merchandise at low prices. We also believe convenience, or the ability to complete a shopping trip in a limited amount of time, is critical to many of our customers and is a key factor that differentiates us from large-box retailers.

We operate in the highly competitive retail industry. We face strong sales competition from other retailers that sell general merchandise and food. Because of Dollar General's low-price strategy, we must strive to keep our operating costs as low as possible. This effort affects all expenses, but is particularly critical as we compete for retail site locations and for qualified talent to manage and operate our stores. The fact that many of our stores are located in towns that many retailers may find too small to support their business model, however, has allowed Dollar General to continue to increase its store count faster than most retailers.

Management of the Company continues to focus on making good investment decisions for the long-term growth and profitability of the Company. In order to better support sales efforts in our stores and to enable the Company to continue its rapid growth, the Company has attempted to strengthen the senior leadership team over the last several years. In 2005, changes were made to the organization structure in order to increase synergies between store operations and new store development and among merchandising, marketing and the supply chain. Executives were added to support our efforts in human resources, real estate, store operations, supply chain and the Dollar General Market concept. Going forward, the Company expects these new leaders to have a positive impact on the overall performance and profitability of the Company.

Along with other retail companies, we are impacted by a number of factors including, but not limited to: cost of product, consumer debt levels, economic conditions, customer preferences, unemployment, labor costs, inflation, fuel prices, weather patterns, insurance costs and accident costs.

Key Items in Fiscal 2005. Despite a difficult economic environment for our customers in 2005, the Company successfully implemented many of the important operating initiatives outlined in last year's Form 10-K, while also increasing sales and earnings per share. The following are some of the more significant accomplishments during the year:

- Total sales increased by 12.0 percent, including sales during the 53rd week, and same-store sales increased by 2.0 percent;
- We opened 734 new stores, including 29 Dollar General Market stores;
- We implemented "EZstore", the Company's initiative designed to improve inventory flow from distribution centers to consumers as well as improve other areas of store operations, including labor scheduling, hiring and training and product presentation, in 3,825 stores as of year-end;
- We completed construction of and opened the Company's eighth DC in South Carolina and began construction of a ninth DC in Indiana to increase over-

all distribution capacity and to decrease stem miles between the DCs and the stores;
- We increased annual inventory turns to 4.2 times in 2005, including the 53rd week, from 4.0 times in 2004 and reduced inventory levels on a per-store basis by 1% as of year end. The Company has executed end-of-season markdowns over the past two years to minimize seasonal inventory carried forward to the following year. The Company made substantial progress on this initiative in 2005 and continues to aggressively identify, evaluate, merchandise and markdown aged inventory;
- We introduced Dollar General gift cards before the Christmas holiday season;
- We introduced Fisher-Price® branded children's apparel and Bobbie Brooks® apparel for women in our stores;
- We developed and installed new systems to provide enhanced store operating statements, supplier communications and transportation and claims management; and
- We generated sufficient cash flow to allow the Company to repurchase approximately 15 million shares of its common stock for $297.6 million and to increase our per share dividend to shareholders by over 9%.

The Company believes its 2005 sales (particularly in more discretionary, higher gross profit categories) were negatively impacted by the effect on its typical low- to middle-income customer of high gasoline and heating fuel prices as well as higher interest rates and increasing consumer debt levels. The Company's gross profit rate was negatively impacted for the year by several factors as further discussed in "Results of Operations" below, but was most notably affected by the decrease, as a percentage of sales, in sales of higher gross profit merchandise categories and higher transportation fuel costs.

In 2005, Hurricanes Katrina and Rita made landfall in the Gulf Coast, impacting our operations, our customers, and our employees. At the peak, approximately 350 stores were temporarily closed due to Hurricane Katrina and 330 stores were temporarily closed due to Hurricane Rita. The Company ultimately closed 41 stores as a result of the hurricanes, and suffered the total destruction of inventory in 29 of those stores due to Hurricane Katrina and 3 of those stores due to Hurricane Rita. Significant losses of inventory and fixed assets, in the form of store fixtures and leasehold improvements, were caused by the hurricanes. These losses were offset by insurance proceeds received during the year. In addition, the Company expects to record additional insurance proceeds in excess of the cost of the asset losses in the future. Significant business interruption was experienced during the hurricanes. The Company did not recover any business interruption insurance proceeds during the year, and will not record any such proceeds until the business interruption claims are substantially settled.

Company Performance Measures. Management uses a number of metrics, including those indicated on the table included in "Results of Operations" below, to assess its performance. The following are the more frequently discussed metrics:
- Earnings per share ("EPS") growth is an indicator of the increased returns generated for the Company's shareholders. EPS of $1.08 in 2005 reflected an increase of 3.8 percent over EPS of $1.04 reported in 2004.
- Total net sales growth indicates, among other things, the success of the Company's selection of new store locations and merchandising strategies. Total net sales increased 12.0% in 2005, including the impact of the 53rd week.
- Same-store sales growth indicates whether our merchandising strategies, store execution and customer service in existing stores have been successful in generating increased sales. Same-store sales increased 2.0 percent in 2005, with stronger same-store sales in the first half of the year than the latter half. Sales were negatively impacted for the year by the economic factors discussed above. However, the latter half of the year was increasingly impacted by promotional efforts of competitors. Same-store sales in 2004 increased by 3.2 percent.
- Operating margin rate (operating profit divided by net sales), which is an indicator of the Company's success in leveraging its fixed costs and managing its variable costs, declined to 6.5 percent in 2005 versus 7.3 percent in 2004. The various components impacting this metric are fully discussed in "Results of Operations" below.
- Free cash flow (the sum of net cash flows from operating activities, net cash flows from investing activities and net cash flows from financing activities, excluding share repurchases and changes in debt other than required payments). Although this measure is a non-GAAP measure, the Company believes it is useful as an indicator of the cash flow generating capacity of the Company's operations. It is also a useful metric to analyze in conjunction with net income to determine whether there is any significant non-cash component to the Company's net income. The Company generat-

ed free cash flow of $250.9 million in 2005 compared to $96.2 million in 2004, as calculated below under "Non-GAAP disclosures."

- Inventory turns (cost of goods sold for the year divided by average inventory balances, at cost, measured at the end of the latest five fiscal quarters) is an indicator of how well the Company is managing the largest asset on its balance sheet. Inventory turns were 4.2 times in 2005, including the 53rd week, compared to 4.0 times in 2004.
- Return on average assets (net income for the year divided by average total assets, measured at the end of the latest five fiscal quarters), is an overall indicator of the Company's effectiveness in deploying its resources. Return on assets was 12.1 percent in 2005 and 12.7 percent in 2004.

While the Company is particularly pleased with the improvement in inventory management and free cash flow generation, we did not achieve our overall internal financial goals set out at the beginning of the year. This shortfall was partially a result of non-controllable economic and other factors that impacted our customers. As a result of the Company's inability to achieve its financial targets, executives and administrative employees did not earn a bonus under the Company's "Teamshare" bonus program. The Company has identified the following opportunities aimed at improving financial performance in 2006.

Key Items for Fiscal 2006. For 2006, the Company has established the following priorities and initiatives aimed at continuing the Company's growth and improving its operating and financial performance while remaining focused on serving its customers:

- Improvement in sales performance of same-stores and new stores through new merchandise additions, improved in-store presentation, and heightened promotional energy aimed at increasing customer traffic and average customer ticket. The Company plans to strengthen its "treasure hunt" offering and to execute a variety of new marketing, promotional and/or advertising strategies. The Company will also implement a new store floor plan in all new stores, emphasizing improved merchandising adjacencies, operational efficiencies and customer service, and will continue efforts referred to as "Project Gold Standard" begun in 2005 to improve the shopability and financial performance of existing stores;
- Further development of the Dollar General Market concept;
- Continued investment in EZstore, further reducing store labor and related costs, with the goal of completing the rollout by the end of 2006;
- Increased efforts to control inventory shrink in the stores, which remains above acceptable levels as a percentage of sales;
- Opening a minimum of 800 new traditional Dollar General stores, while continuing to pursue further geographical expansion, with increased emphasis on site selection, approval processes, and lowering rent as a percentage of sales in new and existing stores; and
- Continued investment in the Company's infrastructure, including increasing global sourcing, further developing our information technology capabilities, and opening the Company's ninth distribution center thereby expanding distribution capacity.

The Company can provide no assurance that it will be successful in executing these initiatives, nor can the Company guarantee that the successful implementation of these initiatives will result in superior financial performance.

Results of Operations

The following discussion of the Company's financial performance is based on the Consolidated Financial Statements set forth herein. The following table contains results of operations data for the 2005, 2004 and 2003 fiscal years, and the dollar and percentage variances among those years.

				2005 vs. 2004		2004 vs. 2003	
(amounts in millions, excluding per share amounts)	2005 (a)	2004	2003	$ change	% change	$ change	% change
Net sales by category:							
Highly consumable	**$ 5,606.5**	$ 4,825.1	$ 4,206.9	**$ 781.4**	**16.2%**	$ 618.2	14.7%
% of net sales	***65.33%***	*62.98%*	*61.22%*				
Seasonal	**1,348.8**	1,264.0	1,156.1	**84.8**	**6.7**	107.9	9.3
% of net sales	***15.72%***	*16.50%*	*16.82%*				
Home products	**907.8**	879.5	860.9	**28.4**	**3.2**	18.6	2.2
% of net sales	***10.58%***	*11.48%*	*12.53%*				
Basic clothing	**719.2**	692.4	648.1	**26.8**	**3.9**	44.3	6.8
% of net sales	***8.38%***	*9.04%*	*9.43%*				
Net sales	**$ 8,582.2**	$ 7,660.9	$ 6,872.0	**$ 921.3**	**12.0%**	$ 788.9	11.5%
Cost of goods sold	**6,117.4**	5,397.7	4,853.9	**719.7**	**13.3**	543.9	11.2
% of net sales	***71.28%***	*70.46%*	*70.63%*				
Gross profit	**2,464.8**	2,263.2	2,018.1	**201.6**	**8.9**	245.1	12.1
% of net sales	***28.72%***	*29.54%*	*29.37%*				
Selling, general and administrative expenses	**1,903.0**	1,706.2	1,500.1	**196.7**	**11.5**	206.1	13.7
% of net sales	***22.17%***	*22.27%*	*21.83%*				
Penalty expense	**–**	–	10.0	**–**	**–**	(10.0)	(100.0)
% of net sales	**–**	–	*0.15%*				
Operating profit	**561.9**	557.0	508.0	**4.9**	**0.9**	49.0	9.6
% of net sales	***6.55%***	*7.27%*	*7.39%*				
Interest income	**(9.0)**	(6.6)	(4.1)	**(2.4)**	**36.9**	(2.5)	60.2
% of net sales	***(0.10)%***	*(0.09)%*	*(0.06)%*				
Interest expense	**26.2**	28.8	35.6	**(2.6)**	**(8.9)**	(6.8)	(19.1)
% of net sales	***0.31%***	*0.38%*	*0.52%*				
Income before income taxes	**544.6**	534.8	476.5	**9.9**	**1.8**	58.2	12.2
% of net sales	***6.35%***	*6.98%*	*6.93%*				
Income taxes	**194.5**	190.6	177.5	**3.9**	**2.1**	13.0	7.3
% of net sales	***2.27%***	*2.49%*	*2.58%*				
Net income	**$ 350.2**	$ 344.2	$ 299.0	**$ 6.0**	**1.7%**	$ 45.2	15.1%
% of net sales	***4.08%***	*4.49%*	*4.35%*				
Diluted earnings per share	**$ 1.08**	$ 1.04	$ 0.89	**$ 0.04**	**3.8%**	$ 0.15	16.9%
Weighted average diluted shares	**324.1**	332.1	337.6	**(7.9)**	**(2.4)**	(5.6)	(1.6)

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

Net Sales. Increases in 2005 net sales resulted primarily from opening additional stores, including 609 net new stores in 2005, and a same-store sales increase of 2.0% for 2005 compared to 2004. Same-store sales calculations for 2005 and prior include only those stores that were open both at the end of that period and at the beginning of the preceding fiscal year. Same-store sales increases are calculated based on the comparable calendar weeks in the prior year. Accordingly, the same store sales percentage for 2005 discussed above excludes sales from the 53rd week as there was no comparable week in 2004. The increase in same-store sales accounted for $144.2 million of the increase in sales. Stores opened since the beginning of 2004, as well as the $162.9 million impact of the 53rd week of sales in fiscal year 2005 for all stores were the primary contributors to the remaining $777.1 million sales increase during 2005. The increase in same-store sales is primarily attributable to an increase in average customer purchase.

The Company has recently revised and published its method for determining the stores that are included in the Company's publicly released same-store sales calculations. Beginning in fiscal 2006, the Company now provides same-store sales calculations for those stores that have been open at least 13 full fiscal months and remain open at the end of the reporting period. Using the revised methodology, the same-store sales increase in 2005 was 2.2%.

The Company monitors its sales internally by the four major categories noted in the table above. The Company's merchandising mix in recent years has shifted to faster-turning consumable products versus seasonal, home products and clothing. This has been driven by customer wants and needs in the marketplace. As a result, over the past three years the highly consumable category has become a greater percentage of the Company's overall sales mix while the percentages of the seasonal, home products and basic clothing categories have declined. Accordingly, the Company's sales increase by merchandise category in 2005 compared to 2004 was primarily attributable to the highly consumable category, which increased by $781.4 million, or 16.2%. The Company believes that future sales growth is dependent upon an increase in the number of customer transactions as well as an increase in the dollar value of the average transaction. The Company continually reviews its merchandise mix and strives to adjust it when deemed necessary as a part of its ongoing efforts to improve overall sales and gross profit. These ongoing reviews may result in a shift in the Company's merchandising strategy which could increase permanent markdowns in the future.

The Company's sales increase in 2004 compared to 2003 resulted primarily from opening additional stores, including 620 net new stores in 2004, and a same-store sales increase of 3.2% for 2004 compared to 2003. The increase in same-store sales accounted for $204.0 million of the increase in sales while stores opened since the beginning of 2003 were the primary contributors to the remaining $585.0 million sales increase during 2004. The Company's sales increase in 2004 was primarily attributable to the highly consumable category, which increased by $618.2 million, or 14.7%.

Gross Profit. The gross profit rate declined by 82 basis points in 2005 as compared with 2004 due to a number of factors, including but not limited to: lower sales (as a percentage of total sales) in the Company's seasonal, home products and basic clothing categories, which have higher than average markups; an increase in markdowns as a percentage of sales primarily as a result of the Company's initiative to reduce per-store inventory; higher transportation expenses primarily attributable to increased fuel costs; an increase in the Company's shrink rate; and an estimated $5.2 million reduction resulting from the expansion of the number of departments utilized for the gross profit calculation from 10 to 23, as further described below under "Critical Accounting Policies and Estimates." These factors were partially offset by higher average mark-ups on the Company's beginning inventory in 2005 as compared with 2004. In 2005 and 2004, the Company experienced inventory shrinkage of 3.22% and 3.05%, respectively.

The gross profit rate increased 17 basis points in 2004 as compared with 2003. Although the Company's gross profit rate was pressured by sales mix shifts to more highly consumable items, which typically carry lower gross profit rates, the Company was able to more than offset this through increases in gross markups on all merchandise categories in 2004. More specific factors include higher initial mark-ups on merchandise received during 2004 as compared with 2003, achieved primarily from the positive impact of opportunistic purchasing, renegotiating product costs with several key suppliers, selective price increases, and an increase in various performance-based vendor rebates; and higher average mark-ups on the Company's beginning inventory in 2004 as compared to 2003, which represents the cumulative impact of higher margin purchases over time. These components of gross profit, which positively impacted the Company's results, were partially offset by an increase in transportation expenses as a percentage of sales, resulting primarily from higher fuel costs

in 2004 as compared to 2003; and a nonrecurring favorable inventory adjustment in 2003 of $7.8 million, representing a change in the Company's estimated provision for shrinkage.

Selling, General and Administrative ("SG&A") Expense. The 10 basis point decrease in SG&A expense as a percentage of sales in 2005 as compared with 2004 was due to a number of factors, including but not limited to the following expense categories that either declined or increased less than the 12.0% increase in sales: employee incentive compensation expense (decreased 37.8%), based upon the Company's fiscal 2005 financial performance; professional fees (decreased 32.3%), primarily due to the reduction of consulting fees associated with the EZstore project and 2004 fees associated with the Company's initial Sarbanes-Oxley compliance effort; and employee health benefits (decreased 10.0%), due in part to a downward revision in claim lag assumptions based upon review and recommendation by the Company's outside actuary and decreased claims costs as a percentage of sales. Partially offsetting these reductions in SG&A were current year increases in store occupancy costs (increased 17.6%), primarily due to rising average monthly rentals associated with the Company's leased store locations, and store utilities costs (increased 22.7%) primarily related to increased electricity and gas expense.

The increase in SG&A expense as a percentage of sales in 2004 as compared with 2003 was due to a number of factors, including but not limited to increases in the following expense categories that were in excess of the 11.5 percent increase in sales: store occupancy costs (increased 17.4%), primarily due to rising average monthly rentals associated with the Company's leased store locations; purchased services (increased 54.6%), due primarily to fees associated with the increased customer usage of debit cards; professional fees (increased 119.2%), primarily due to consulting fees associated with both the Company's 2004 EZstore project and compliance with certain provisions of the Sarbanes-Oxley Act of 2002; and inventory services (increased 88.2%), due to both an increased number of physical inventories and a higher average cost per physical inventory. Partially offsetting these increases was a reduction in accruals for employee bonus expenses (declined 21.3%), primarily related to higher bonus expense in 2003 resulting from the Company's financial performance during 2003.

Penalty Expense. During 2003, the Company recorded a charge of $10.0 million relating to a civil penalty resulting from its agreement in principle with the Securities and Exchange Commission ("SEC") staff to settle the matters arising out of a restatement of the Company's financial statements for fiscal years 2001 and prior.

Interest Income. The increase in interest income in 2005 compared to 2004 is due primarily to higher interest earned on short-term investments due to increased interest rates on short-term borrowings. The increase in interest income in 2004 compared to 2003 is due primarily to interest income on certain notes receivable purchased in May 2003 relating to the Company's South Boston DC, as further discussed below under Liquidity and Capital Resources.

Interest Expense. The decrease in interest expense in 2005 is primarily attributable to a reduction in tax related interest expense of $1.4 million, principally due to the reversal of interest accruals pertaining to certain income tax related contingencies that were resolved during 2005. The decrease in interest expense in 2004 compared to 2003 is due primarily to capitalized interest of $3.6 million related to the Company's DC construction and expansion projects in 2004 compared to $0.2 million in 2003 and a reduction in amortization of debt issuance costs of $2.2 million due in part to the amendment of the Company's revolving credit facility in June 2004. The Company had variable-rate debt of $14.5 million as of February 3, 2006. The remainder of the Company's outstanding indebtedness at February 3, 2006 and all of its outstanding indebtedness at January 28, 2005 was fixed rate debt.

Income Taxes. The effective income tax rates for 2005, 2004 and 2003 were 35.7%, 35.6% and 37.3%, respectively.

While the 2005 and 2004 rates were similar overall, the rates contained offsetting differences. Non-recurring factors causing the 2005 tax rate to increase when compared to the 2004 tax rate include a reduction in federal jobs credits of approximately $1.0 million, additional net foreign income tax expense of approximately $0.8 million and a decrease in the contingent income tax reserve due to resolution of contingent liabilities that is $3.6 million less than the decrease that occurred in 2004. Non-recurring factors causing the 2005 tax rate to decrease when compared to the 2004 tax rate include the recognition of state tax credits of approximately $2.3 million related to the Company's construction of a DC in Indiana and a non-recurring benefit of approximately $2.6 million related to an internal restructuring that was completed during 2005. Excluding the non-recurring

items, the 2005 effective tax rate would have been approximately 36.5%.

The 2004 rate was lower than the 2003 rate primarily due to the reversal of certain contingent income tax liabilities of approximately $6.2 million in 2004, when the Company adjusted its tax contingency reserve based upon the results of two state income tax examinations. The tax rate in 2003 was negatively impacted by the $10.0 million penalty expense in 2003, as discussed above, which was not deductible for income tax purposes.

In 2005, the Company recognized a reduction in its federal income tax expense of approximately $4.5 million for federal jobs related tax credits. Of this amount, approximately $3.9 million relates to the Work Opportunity Tax Credit (WOTC), the Welfare to Work Credit (WtW) and the Native American Employment Credit. The federal law that provided for the WOTC and WtW credit programs expired on December 31, 2005 for employees hired after that date. Credits can continue to be earned in 2006 for eligible employees that were hired prior to the December 31, 2005 date. The federal law that provided for the Native American Employment Credit expired for years beginning after December 31, 2005 (the Company's 2006 year) without regard to when the employee was hired. The Company currently anticipates that Congress will renew these credit programs on a retroactive basis; however, renewal cannot currently be assured. Should these credit programs not be renewed, the Company currently anticipates a reduction in its 2006 credits of approximately $3.1 million.

Liquidity and Capital Resources

Current Financial Condition / Recent Developments. During the past three years, the Company has generated an aggregate of approximately $1.46 billion in cash flows from operating activities. During that period, the Company has expanded the number of stores it operates by approximately 30% (over 1,800 stores) and has incurred approximately $713 million in capital expenditures, primarily to support this growth. Also during this three-year period, the Company has expended approximately $537 million for repurchases of its common stock and paid dividends of approximately $156 million.

The Company's inventory balance represented approximately 49% of its total assets as of February 3, 2006. The Company's proficiency in managing its inventory balances can have a significant impact on the Company's cash flows from operations during a given fiscal year. For example, in 2005, changes in inventory balances represented a much less significant use of cash ($97.9 million, as explained in more detail below), as compared to changes in inventory balances in 2004 ($219.4 million use of cash).

As described in Note 7 to the Consolidated Financial Statements, the Company is 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 the Company's liquidity. The Company also has certain income tax-related contingencies as more fully described below under "Critical Accounting Policies and Estimates". Estimates of these contingent liabilities are included in the Company's Consolidated Financial Statements. However, future negative developments could have a material adverse effect on the Company's liquidity. See Notes 4 and 7 to the Consolidated Financial Statements.

On September 30, 2005, November 30, 2004 and March 13, 2003, the Board of Directors authorized the Company to repurchase up to 10 million, 10 million and 12 million shares, respectively, of its outstanding common stock. These authorizations allow or allowed, as applicable, 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 is to enhance shareholder value by purchasing shares at a price that produces a return on investment that is greater than the Company's cost of capital. Additionally, share repurchases generally are undertaken only if such purchases result in an accretive impact on the Company's fully diluted earnings per share calculation. The 2005 authorization expires September 30, 2006. The 2004 and 2003 authorizations were completed prior to their expiration dates. During 2005, the Company purchased approximately 15.0 million shares pursuant to the 2005 and 2004 authorizations at a total cost of $297.6 million. During 2004, the Company purchased approximately 11.0 million shares pursuant to the 2004 and 2003 authorizations at a total cost of $209.3 million. During 2003, the Company purchased approximately 1.5 million shares pursuant to the 2003 authorization at a total cost of $29.7 million. Share repurchases in 2005 increased diluted earnings per share by approximately $0.01.

The following table summarizes the Company's significant contractual obligations as of February 3, 2006 (in thousands):

	Payments Due by Period				
Contractual obligations (a)	Total	< 1 yr	1-3 yrs	3-5 yrs	> 5 yrs
Long-term debt	$ 214,473	$ –	$ –	$ 199,978	$ 14,495
Capital lease obligations	22,028	7,862	7,992	1,148	5,026
Financing obligations	89,586	2,031	5,136	4,684	77,735
Inventory purchase obligations	85,148	85,148	–	–	–
Interest (b)	169,466	25,933	49,895	39,772	53,866
Operating leases	1,368,848	281,615	424,225	269,466	393,542
Total contractual cash obligations	$1,949,549	$ 402,589	$ 487,248	$ 515,048	$ 544,664

(a) The Company has self-insurance liabilities of $154.7 million that are not reflected in the table above due to the absence of scheduled maturities.

(b) Represents obligations for interest payments on long-term debt, capital lease and financing obligations. Excludes interest on $14.5 million of variable rate long-term debt issued in 2005 which interest, on an annualized basis, would have equaled approximately $0.6 million in 2005.

In fiscal year 2005, the Company's 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 30% of ARIC's liability for insurance losses in the form of certain specified types of assets and as such, these investments are not available for general corporate purposes. At February 3, 2006, these cash and cash equivalents and investments balances totaled $43.4 million.

The Company has a $250 million revolving credit facility (the "Credit Facility"), which expires in June 2009. As of February 3, 2006, the Company had no outstanding borrowings or standby letters of credit outstanding under the Credit Facility. Outstanding standby letters of credit reduce the borrowing capacity of the Credit Facility. The Credit Facility contains certain financial covenants. The Company was in compliance with all these financial covenants at February 3, 2006. See Note 5 to the Consolidated Financial Statements for further discussion of the Credit Facility.

The Company has $200 million (principal amount) of 8 5/8% unsecured notes due June 15, 2010. This indebtedness was incurred to assist in funding the Company's growth. Interest on the notes is payable semi-annually on June 15 and December 15 of each year. The Company may seek, from time to time, to retire the notes through cash purchases on the open market, in privately negotiated transactions or otherwise. Such repurchases, if any, will depend on prevailing market conditions, the Company's liquidity requirements, contractual restrictions and other factors. The amounts involved may be material.

In July 2005, as an inducement for the Company to select Marion, Indiana as the site for construction of a new DC, the Economic Development Board of Marion approved a tax increment financing in the amount of $14.5 million, which matures February 1, 2035. Pursuant to this financing, proceeds from the issuance of certain revenue bonds were loaned to the Company in connection with the construction of this DC. The variable interest rate on this loan is based on the weekly remarketing of the bonds, which are supported by a bank letter of credit, and ranged from 3.52% to 4.60% in 2005.

Significant terms of the Company's outstanding debt obligations could have an effect on the Company's ability to incur additional debt financing. The Credit Facility contains financial covenants, which include limits on certain debt to cash flow ratios, a fixed charge coverage test, and minimum allowable consolidated net worth. The Credit Facility also places certain specified limitations on secured and unsecured debt. The Company's outstanding notes discussed above place certain specified limitations on secured debt and place certain limitations on the Company's ability to execute sale-leaseback transactions. The Company has generated significant cash flows from its operations during recent years. The Company had peak borrowings under the Credit Facility of $100.3 million during 2005 and $73.1 million during 2004, all of which were repaid prior to February 3, 2006 and January 28, 2005, respectively, and had no borrowings outstanding under the Credit Facility at any time during 2003. Therefore, the Company does not believe that any existing limitations on its ability to incur additional indebtedness will have a material impact on its liquidity. Notes 5 and 7 to the Consolidated Financial Statements contain additional disclosures related to the Company's debt and financing obligations.

At February 3, 2006 and January 28, 2005, the Company had commercial letter of credit facilities totaling $195.0 million and $215.0 million, respectively, of which $85.1 million and $98.8 million, respectively, were outstanding for the funding of imported merchandise purchases.

During 2005, the Company incurred significant losses caused by Hurricane Katrina, primarily inventory and fixed assets, in the form of store fixtures and leasehold improvements. The Company has received insurance proceeds of $8.0 million due to these losses, and has utilized a portion of these proceeds to replace lost assets. The Company expects to receive additional insurance proceeds, due in part to significant business interruption experienced during the hurricanes. The Company did not recover any business interruption proceeds during 2005, and will not record any such proceeds until the business interruption claims are substantially settled. Losses related to inventory are included in cash flows provided by operating activities while losses related to fixed assets are included in cash flows used in investing activities. The insurance proceeds approximated the amount of losses recorded by the Company, resulting in no material impact on reported 2005 net income.

The Company believes that its existing cash balances ($200.6 million at February 3, 2006), cash flows from operations ($555.5 million generated in 2005), the Credit Facility ($250 million available at February 3, 2006) and its anticipated ongoing access to the capital markets, if necessary, will provide sufficient financing to meet the Company's currently foreseeable liquidity and capital resource needs.

Cash flows provided by operating activities. Cash flows from operating activities for 2005 compared to 2004 increased by $164.0 million. The most significant component of the increase in cash flows from operating activities in the 2005 period as compared to the 2004 period was the changes in inventory balances. Seasonal inventory levels increased by 10% in 2005 as compared to a 22% increase in 2004, home products inventory levels increased by 2% in 2005 as compared to a 16% increase in 2004, while basic clothing inventory levels declined by 5% in 2005 as compared to a 21% increase in 2004. Total merchandise inventories at the end of 2005 were $1.47 billion compared to $1.38 billion at the end of 2004, a 7.1 percent increase overall, but a 1% decrease on a per store basis, reflecting the Company's focus on lowering its per store inventory levels. In connection with this effort, the Company has completed an initiative of identifying specific merchandise in its stores that it intends to sell via promotional discounts to customers. Some of these items have already been marked down and some may require additional markdowns in future periods. The future rate of sales of this merchandise will be a key determinant of the rate of future markdowns.

Cash flows from operating activities for 2004 compared to 2003 declined by $122.6 million. The most significant component of the change in cash flows from operating activities was an increase in inventory levels in 2004. Total merchandise inventories at the end of 2004 were $1.38 billion compared to $1.16 billion at the end of 2003, a 19 percent increase, or a 9 percent increase on a per store basis, with the remainder primarily attributable to growth in the number of stores. The largest portion of the increase in inventories resulted from the Company's focus on improving in-stock levels of core merchandise at the stores. New initiatives, including the expansion of the perishable food program and the addition of certain core apparel items, magazines and Hispanic food items also contributed to the inventory increase. In addition, due to an early Easter in 2005, the Company received more seasonal merchandise for Spring 2005 before the end of fiscal 2004. Cash flows in 2004 increased by $45.3 million over 2003 related to changes in income taxes payable, primarily due to a large payment of federal income taxes for 2002 that was made in 2003. Cash flows in the 2004 period were positively impacted by an increase in net income of $45.2 million driven by improved operating results (as more fully discussed above under "Results of Operations").

Cash flows used in investing activities. Cash flows used in investing activities of $264.4 million in 2005 were primarily related to capital expenditures. Significant components of the Company's 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 EZstore project; $18 million for certain fixtures in existing stores; and $15 million for various systems-related capital projects. During 2005, the Company opened 734 new stores and relocated or remodeled 82 stores. Distribution and transportation expenditures in 2005 included costs associated with the construction of the Company's new DCs in South Carolina and Indiana.

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

Cash flows used in investing activities of $259.2 million in 2004 were also primarily related to capital expenditures.

Significant components of the Company's purchases of property and equipment in 2004 included the following approximate amounts: $101 million for distribution and transportation-related capital expenditures; $82 million for new stores; $26 million for certain fixtures in existing stores; $26 million for various systems-related capital projects; and $23 million for coolers in existing stores, which allow the stores to carry refrigerated products. During 2004, the Company opened 722 new stores and relocated or remodeled 80 stores. Distribution and transportation expenditures in 2004 included costs associated with the construction of the Company's new DC in South Carolina as well as costs associated with the expansion of the Ardmore, Oklahoma and South Boston, Virginia DCs.

Net sales of short-term investments in 2004 of $25.8 million primarily reflect the Company's investment activities in tax-exempt auction market securities.

Cash flows used in investing activities totaled $256.7 million in 2003. The Company's purchases of property and equipment in 2003 included the following approximate amounts: $63 million for new, relocated and remodeled stores; $22 million for systems-related capital projects; and $25 million for distribution and transportation-related capital expenditures. During 2003, the Company opened 673 new stores and relocated or remodeled 76 stores. Systems-related projects in 2003 included approximately $6 million for point-of-sale and satellite technology and $3 million related to debit/credit/EBT technology. Distribution and transportation expenditures in 2003 included approximately $19 million at the Ardmore, Oklahoma and South Boston, Virginia DCs primarily related to the ongoing expansion of those facilities.

Net purchases of short-term investments in 2003 of $67.2 million primarily reflect the Company's investment activities in tax-exempt auction market securities.

During 2003, the Company purchased two secured promissory notes totaling $49.6 million which represent debt issued by a third party entity from which the Company leases its DC in South Boston, Virginia. See Note 7 to the Company's Consolidated Financial Statements.

Capital expenditures during 2006 are projected to be approximately $375 million. The Company anticipates funding its 2006 capital requirements with cash flows from operations and the Credit Facility, if necessary. Significant components of the 2006 capital plan include the completion of construction of the new DC in Indiana and anticipated costs related to the Company's planned tenth DC; leasehold improvements and fixtures and equipment for approximately 800 new stores, which includes 30 new Dollar General Market stores; the continued rollout of the Company's EZstore project; and additional investments in technology and systems. The Company plans to undertake these expenditures in order to improve its infrastructure and provide support for its anticipated growth.

Cash flows used in financing activities. Cash flows used in financing activities were $323.3 million in 2005. The Company repurchased approximately 15.0 million shares of its common stock at a total cost of $297.6 million, paid cash dividends of $56.2 million, or $0.175 per share, on its outstanding common stock, and expended $14.3 million to reduce its outstanding capital lease and financing obligations. Also in 2005, the Company received proceeds of $14.5 million from the issuance of a tax increment financing in conjunction with the construction of its new DC in Indiana. During 2004, the Company repurchased approximately 11.0 million shares of its common stock at a total cost of $209.3 million, paid cash dividends of $52.7 million, or $0.16 per share, on its outstanding common stock and expended $16.4 million to reduce its outstanding capital lease and financing obligations. During 2003, the Company repurchased approximately 1.5 million shares of its common stock at a total cost of $29.7 million, paid cash dividends of $46.9 million, or $0.14 per share, on its outstanding common stock, and expended $15.9 million to reduce its outstanding capital lease and financing obligations. These uses of cash were partially offset by proceeds from the exercise of stock options during 2005, 2004 and 2003 of $29.4 million, $34.1 million and $49.5 million, respectively. The majority of the remaining borrowings and repayments were a result of activity associated with daily cash needs of the Company.

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 the Company's financial statements that require estimation, but are not deemed critical as defined below. The Company 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.

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 its critical accounting estimates with the Audit Committee of the

Company's Board of Directors and the Audit Committee has reviewed the disclosures presented below relating to them.

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 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 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 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 lower of cost or market ("LCM") and/or LIFO reserves.

To reduce the potential of such distortions in the valuation of inventory, the Company's RIM calculation through the end of 2004 utilized 10 departments in which fairly homogenous classes of merchandise inventories having similar gross profit rates were grouped. In 2005, in order to further refine its RIM calculation, the Company expanded the number of departments it utilizes for its gross profit calculation from 10 to 23. The impact of this change on the Company's Consolidated Statement of Income for 2005 was an estimated reduction of gross profit and a corresponding decrease to inventory, at cost, of $5.2 million. Other factors that reduce potential distortion include the use of historical experience in estimating the shrink provision (see discussion below) and the utilization of an independent statistician to assist in the LIFO sampling process and index formulation. Also, on an ongoing basis, the Company reviews and evaluates the salability of its inventory and records LCM reserves, if necessary.

The Company calculates its 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 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. Beginning in 2003, in an effort to improve this estimate, the Company began applying store-specific shrink rates to store-specific sales generated subsequent to a given store's physical inventory. Prior to 2003, the Company applied a weighted-average shrink rate to all Company sales generated subsequent to physical inventories. During 2005, in an attempt to further refine its shrink accrual, the Company changed from a store-level shrink accrual to a store- and department-level shrink accrual. To the extent that subsequent physical inventories yield different results than this estimated accrual, the Company's effective shrink rate for a given reporting period will include the impact of adjusting the estimated results to the actual results. Although the Company performs physical inventories in all of its 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.

During 2003, the Company implemented an item-level perpetual inventory system. This system provides better information regarding the type of inventory that the Company owns and improves the Company's ability to estimate its shrink provision as discussed above. The utilization of this improved information in the Company's RIM calculation resulted in a non-recurring inventory adjustment of approximately $7.8 million, which favorably impacted gross profit in the third quarter of 2003.

Property and Equipment. Property and equipment are recorded at cost. The Company 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 the assignment of useful depreciable lives involves significant judgments and the use of estimates. Property and equipment are reviewed for impairment periodically and whenever events or changes in circumstances

indicate that the carrying value of an asset may not be recoverable.

Insurance Reserves. The Company retains a significant portion of the risk for its workers' compensation, employee health insurance, general liability, property loss and automobile coverage. These costs are significant primarily due to the large employee base and number of stores. Provisions are made to this insurance liability on an undiscounted basis based on actual claim data and estimates of incurred but not reported claims developed by an independent actuary utilizing historical claim trends. If future claim trends deviate from recent historical patterns, the Company may be required to record additional expenses or expense reductions, which could be material to the Company's future financial results.

Contingent Liabilities – Income Taxes. The Company is subject to routine income tax audits that occur periodically in the normal course of business. The Company estimates its contingent income tax liabilities based on its assessment of probable income tax-related exposures and the anticipated settlement of those exposures translating into actual future liabilities. The contingent liabilities are estimated based on both historical audit experiences with various state and federal taxing authorities and the Company's interpretation of current income tax-related trends. If the Company's income tax contingent liability estimates prove to be inaccurate, the resulting adjustments could be material to the Company's future financial results.

Contingent Liabilities - Legal Matters. The Company is subject to legal, regulatory and other proceedings and claims. Reserves, if any, are established 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 the Company's financial statements and SEC filings, management's view of the Company's exposure. The Company reviews outstanding claims and proceedings with external counsel to assess probability and estimates of loss. These assessments are re-evaluated each quarter or as new information becomes available to determine whether a reserve should be established or if any existing reserve should be adjusted. The actual cost of resolving a claim or proceeding ultimately may be substantially different than the amount of the recorded reserve. In addition, because it is not permissible under GAAP to establish a litigation reserve until the loss is both probable and estimable, in some cases there may be insufficient time to establish a reserve 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. The majority of the Company's stores are subject to short-term leases (usually with initial or primary terms 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 between 7 and 10 years with multiple renewal options. Approximately half of the Company's stores have provisions for contingent rentals based upon a percentage of defined sales volume. The Company recognizes contingent rental expense when the achievement of specified sales targets are considered probable. 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 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 in 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. 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 undiscounted cash flows or the appraised values of the underlying assets. The Company may adjust the net book value of the underlying assets based upon such cash flow analysis compared to the book value and may also consider appraised values. Assets to be disposed of are adjusted to the fair value less the cost to sell if less than the book value. The Company also records impairment charges to reduce the carrying value of certain of its stores' assets as deemed necessary due to negative sales trends and cash flows.

Effects of Inflation

The Company believes that inflation and/or deflation had a minimal impact on its overall operations during 2005, 2004 and 2003.

Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 123(R), "Share-Based Payment," which will require an entity to measure compensation cost for all share-based payments (including grants of employee stock options) at fair value. The Company will adopt SFAS No. 123(R) during the first quarter of 2006 and expects to apply the standard using the modified prospective method, which requires compensation expense to be recorded for new and modified awards and also for unvested portions of previously issued and outstanding awards. The Company expects to incur incremental Selling, general and administrative expense associated with the adoption of approximately $5 million in 2006, dependent upon the number of grants and their related fair market values. See Note 1 to the Consolidated Financial Statements for disclosure of the pro forma effects of stock option grants as determined using the methodology prescribed under SFAS No. 123.

SFAS No. 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. While the Company cannot estimate what those amounts will be in the future (because they depend on, among other things, when employees exercise stock options), the amounts of operating cash flows recognized in the accompanying Consolidated Statements of Cash Flows for such excess tax deductions were $6.5 million, $9.7 million and $14.6 million for 2005, 2004 and 2003, respectively.

On January 24, 2006, the Compensation Committee ("Committee") of the Company's Board of Directors approved the acceleration of vesting for 6.4 million of the Company's outstanding stock options awarded prior to August 2, 2005. This acceleration was effective on February 3, 2006. Vesting was not accelerated for stock options held by the CEO and stock options granted in 2005 to the officers of the Company at the level of Executive Vice President or higher. In addition, pursuant to that 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 higher, 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 stock options was made primarily to reduce non-cash compensation expense that would have been recorded in future periods following the adoption of SFAS No. 123(R) in the first quarter of fiscal year 2006. This action is expected to enable the Company to eliminate approximately $28 million of expense, before income taxes, over the four year period during which the stock options would have vested, subject to the impact of additional adjustments related to the forfeiture of certain stock options. The Company also believes this decision benefits employees. In connection with the acceleration and in accordance with the provisions of APB 25, the Company recorded compensation expense of $0.9 million, before income taxes, during 2005.

In March 2005, the FASB issued FASB Interpretation 47, "Accounting for Conditional Asset Retirement Obligations" ("FIN 47"), which is effective no later than the end of fiscal years ending after December 15, 2005. This Interpretation clarifies that the term conditional asset retirement obligation as used in FASB Statement No. 143, "Accounting for Asset Retirement Obligations," refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Thus, the timing and (or) method of settlement may be conditional on a future event. Accordingly, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. The fair value of a liability for the conditional asset retirement obligation should be recognized when incurred—generally upon acquisition, construction, or development and (or) through the normal operation of the asset. Uncertainty about the timing and (or) method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists. Statement 143 acknowledges that in some cases, sufficient information may not be available to reasonably estimate the fair value of an asset retirement obligation. This Interpretation also clarifies when an entity would have suf-

ficient information to reasonably estimate the fair value of an asset retirement obligation. The Company adopted the provisions of FIN 47 during the fourth quarter of 2005, and this adoption did not have a material impact on the Company's Consolidated Financial Statements as a whole.

Non-GAAP disclosures

The Company has included in this document free cash flow generated in 2005 and 2004. Free cash flow is a measure not derived in accordance with generally accepted accounting principles ("GAAP"). The Company believes that this information is useful to investors as an indicator of the cash flow generating capacity of the Company's operations. It is also a useful metric to analyze in conjunction with net income to determine whether there is any significant non-cash component to the Company's net income. This information should not be considered a substitute for any measures derived in accordance with GAAP. Management may use this information to better understand the Company's underlying operating results.

A reconciliation of the Company's calculation of free cash flow to the most comparable measure derived in accordance with GAAP is set forth below.

	For the years ended		
(In thousands)	February 3, 2006	January 28, 2005	January 30, 2004
	(53 weeks)	(52 weeks)	(52 weeks)
Net increase (decrease) in cash and cash equivalents (a)	**$ (32,221)**	$(113,069)	$ 214,115
Less issuance of long-term borrowings	**(14,495)**	–	–
Plus repurchases of common stock	**297,602**	209,295	29,687
Free cash flow	**$ 250,886**	$ 96,226	$ 243,802

(a) Equal to the sum of net cash flows from operating activities, net cash flows from investing activities and net cash flows from financing activities.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Financial Risk Management

The Company is exposed to market risk primarily from adverse changes in interest rates. To minimize such risk, the Company may periodically use financial instruments, including derivatives. As a matter of policy, the Company does not buy or sell financial instruments for speculative or trading purposes and all financial instrument transactions must be authorized and executed pursuant to approval by the Board of Directors. All financial instrument positions taken by the Company are used to reduce risk by hedging an underlying economic exposure. Because of high correlation between the 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 used by the Company are straightforward instruments with liquid markets.

The Company has cash flow exposure relating to variable interest rates associated with its revolving line of credit and tax increment financing, and may periodically seek to manage this risk through the use of interest rate derivatives. The primary interest rate exposure on variable rate obligations is based on the London Interbank Offered Rate ("LIBOR"). The Company was not party to any interest rate derivatives in 2005 or 2004.

At February 3, 2006 and January 28, 2005, the fair value of the Company's debt, excluding capital lease obligations, was approximately $281.0 million and $275.9 million, respectively (net of the fair value of a note receivable on the South Boston, Virginia DC of approximately $49.5 million and $50.0 million, respectively, as further discussed in Note 7 to the Consolidated Financial Statements), based upon the estimated market value of the debt at those dates. Such fair value exceeded the carrying values of the debt at February 3, 2006 and January 28, 2005 by approximately $24.2 million and $32.7 million, respectively.

Based upon the Company's variable rate borrowing levels, a 1% adverse change in interest rates would have resulted in a pre-tax reduction of earnings and cash flows on an annualized basis of approximately $0.1 million in 2005 and less than $0.1 million in 2004. In 2003, the Company had no outstanding variable rate borrowings. Based upon the Company's outstanding indebtedness at February 3, 2006 and January 28, 2005, a 1% reduction in interest rates would have resulted in an increase in the fair value of the Company's fixed rate debt of approximately $12.2 million and $14.2 million, respectively.

MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Dollar General prepared and is responsible for the consolidated financial statements and all related financial information contained in this document. This responsibility includes establishing and maintaining effective internal control over financial reporting as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

To comply with the requirements of Section 404 of the Sarbanes–Oxley Act of 2002, management designed and implemented a structured and comprehensive assessment process to evaluate its internal control over financial reporting. The assessment of the effectiveness of the Company's internal control over financial reporting was based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Because of its inherent limitations, a system of internal control over financial reporting can provide only reasonable assurance and may not prevent or detect misstatements. Management regularly monitors its internal control over financial reporting, and actions are taken to correct any deficiencies as they are identified. Based on its assessment, management has concluded that the Company's internal control over financial reporting is effective as of February 3, 2006.

Management's assessment of the effectiveness of internal control over financial reporting as of February 3, 2006, has been audited by Ernst & Young LLP, the independent registered public accounting firm who also audited the Company's consolidated financial statements. Ernst & Young's attestation report on management's assessment of the Company's internal control over financial reporting is contained below.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON INTERNAL CONTROL OVER FINANCIAL REPORTING

To the Board of Directors and Shareholders of
Dollar General Corporation
Goodlettsville, Tennessee

We have audited management's assessment, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting, that Dollar General Corporation and subsidiaries maintained effective internal control over financial reporting as of February 3, 2006, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Dollar General Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit 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 effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Dollar General Corporation and subsidiaries maintained effective internal control over financial reporting as of February 3, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Dollar General Corporation and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of February 3, 2006, based on the COSO criteria.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Dollar General Corporation and subsidiaries as of February 3, 2006 and January 28, 2005, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended February 3, 2006 and our report dated March 16, 2006 expressed an unqualified opinion thereon.

Nashville, Tennessee
March 16, 2006

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

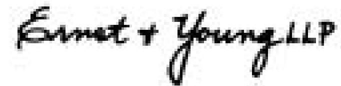
To the Board of Directors and Shareholders of
Dollar General Corporation
Goodlettsville, Tennessee

We have audited the accompanying consolidated balance sheets of Dollar General Corporation and subsidiaries as of February 3, 2006 and January 28, 2005, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended February 3, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Dollar General Corporation and subsidiaries as of February 3, 2006 and January 28, 2005, and the consolidated results of their operations and their cash flows for each of the three years in the period ended February 3, 2006, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Dollar General Corporation and subsidiaries' internal control over financial reporting as of February 3, 2006, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 16, 2006 expressed an unqualified opinion thereon.



Nashville, Tennessee
March 16, 2006

CONSOLIDATED BALANCE SHEETS

(In thousands except per share amounts)

	February 3, 2006	January 28, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 200,609**	$ 232,830
Short-term investments	**8,850**	42,925
Merchandise inventories	**1,474,414**	1,376,537
Deferred income taxes	**11,912**	24,908
Prepaid expenses and other current assets	**67,140**	53,702
Total current assets	**1,762,925**	1,730,902
Net property and equipment	**1,192,172**	1,080,838
Other assets, net	**37,090**	29,264
Total assets	**$ 2,992,187**	$ 2,841,004
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term obligations	**$ 8,785**	$ 12,860
Accounts payable	**508,386**	409,327
Accrued expenses and other	**372,920**	333,889
Income taxes payable	**43,706**	69,616
Total current liabilities	**933,797**	825,692
Long-term obligations	**269,962**	258,462
Deferred income taxes	**67,633**	72,385
Commitments and contingencies		
Shareholders' equity:		
Series B junior participating preferred stock, stated value $0.50 per share; Shares authorized: 10,000; Issued: None	**–**	–
Common stock, par value $0.50 per share; Shares authorized: 500,000; Issued: 2005-315,679; 2004-328,172	**157,840**	164,086
Additional paid-in capital	**462,383**	421,600
Retained earnings	**1,106,165**	1,102,457
Accumulated other comprehensive loss	**(794)**	(973)
Other shareholders' equity	**(4,799)**	(2,705)
Total shareholders' equity	**1,720,795**	1,684,465
Total liabilities and shareholders' equity	**$ 2,992,187**	$ 2,841,004

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

CONSOLIDATED STATEMENTS OF INCOME

(In thousands except per share amounts)

	For the years ended		
	February 3, 2006 (53 weeks)	January 28, 2005 (52 weeks)	January 30, 2004 (52 weeks)
Net sales	**$ 8,582,237**	$ 7,660,927	$ 6,871,992
Cost of goods sold	**6,117,413**	5,397,735	4,853,863
Gross profit	**2,464,824**	2,263,192	2,018,129
Selling, general and administrative	**1,902,957**	1,706,216	1,500,103
Penalty expense	**–**	–	10,000
Operating profit	**561,867**	556,976	508,026
Interest income	**(9,001)**	(6,575)	(4,103)
Interest expense	**26,226**	28,794	35,606
Income before income taxes	**544,642**	534,757	476,523
Income taxes	**194,487**	190,567	177,521
Net income	**$ 350,155**	$ 344,190	$ 299,002
Earnings per share:			
Basic	**$ 1.09**	$ 1.04	$ 0.89
Diluted	**$ 1.08**	$ 1.04	$ 0.89
Weighted average shares:			
Basic	**321,835**	329,376	334,697
Diluted	**324,133**	332,068	337,636

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
Balances, January 31, 2003	333,340	$ 166,670	$ 313,269	$ 791,597	$ (1,349)	$ (2,742)	$ 1,267,445
Comprehensive income:							
Net income	–	–	–	299,002	–	–	299,002
Reclassification of net loss on derivatives	–	–	–	–	188	–	188
Comprehensive income							299,190
Cash dividends, $0.14 per common share	–	–	–	(46,883)	–	–	(46,883)
Issuance of common stock under stock incentive plans	4,240	2,120	47,365	–	–	–	49,485
Tax benefit from stock option exercises	–	–	14,565	–	–	–	14,565
Repurchases of common stock	(1,519)	(759)	–	(28,928)	–	–	(29,687)
Purchase of common stock by employee deferred compensation trust, net (11 shares)	–	–	(157)	–	–	3	(154)
Issuance of restricted stock	129	64	1,904	–	–	(1,968)	–
Amortization of unearned compensation on restricted stock	–	–	–	–	–	354	354
Other equity transactions	–	–	(16)	–	–	–	(16)
Balances, January 30, 2004	336,190	$ 168,095	$ 376,930	$ 1,014,788	$ (1,161)	$ (4,353)	$ 1,554,299
Comprehensive income:							
Net income	–	–	–	344,190	–	–	344,190
Reclassification of net loss on derivatives	–	–	–	–	188	–	188
Comprehensive income							344,378
Cash dividends, $0.16 per common share	–	–	–	(52,682)	–	–	(52,682)
Issuance of common stock under stock incentive plans	2,875	1,437	32,691	–	–	–	34,128
Tax benefit from stock option exercises	–	–	9,657	–	–	–	9,657
Repurchases of common stock	(11,020)	(5,510)	–	(203,785)	–	–	(209,295)
Purchase of common stock by employee deferred compensation trust, net (25 shares)	–	–	(92)	–	–	(377)	(469)
Issuance of restricted stock and restricted stock units, net	128	64	2,398	–	–	(2,462)	–
Amortization of unearned compensation on restricted stock and restricted stock units	–	–	–	–	–	1,779	1,779
Deferred compensation obligation	–	–	–	–	–	2,708	2,708
Other equity transactions	(1)	–	16	(54)	–	–	(38)
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 9)	**–**	**–**	**938**	**–**	**–**	**–**	**938**
Other equity transactions	**(14)**	**(7)**	**(138)**	**(151)**	**–**	**–**	**(296)**
Balances, February 3, 2006	**315,679**	**$157,840**	**$ 462,383**	**$1,106,165**	**$ (794)**	**$ (4,799)**	**$1,720,795**

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	For the years ended		
	February 3, 2006 (53 weeks)	January 28, 2005 (52 weeks)	January 30, 2004 (52 weeks)
Cash flows from operating activities:			
Net income	**$ 350,155**	$ 344,190	$ 299,002
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	**186,824**	164,478	154,457
Deferred income taxes	**8,244**	25,751	18,611
Tax benefit from stock option exercises	**6,457**	9,657	14,565
Change in operating assets and liabilities:			
Merchandise inventories	**(97,877)**	(219,396)	(34,110)
Prepaid expenses and other current assets	**(13,438)**	(3,666)	(16,304)
Accounts payable	**87,230**	22,258	33,265
Accrued expenses and other	**40,376**	35,048	60,523
Income taxes	**(26,017)**	23,793	(21,464)
Other	**13,531**	(10,598)	5,520
Net cash provided by operating activities	**555,485**	391,515	514,065
Cash flows from investing activities:			
Purchases of property and equipment	**(284,112)**	(288,294)	(140,139)
Purchases of short–term investments	**(132,775)**	(221,700)	(201,950)
Sales of short-term investments	**166,850**	247,501	134,725
Purchase of promissory notes	**–**	–	(49,582)
Purchases of long-term investments	**(16,995)**	–	–
Insurance proceeds related to property and equipment	**1,210**	–	–
Proceeds from sale of property and equipment	**1,419**	3,324	269
Net cash used in investing activities	**(264,403)**	(259,169)	(256,677)
Cash flows from financing activities:			
Borrowings under revolving credit facility	**232,200**	195,000	–
Repayments of borrowings under revolving credit facility	**(232,200)**	(195,000)	–
Issuance of long-term obligations	**14,495**	–	–
Repayments of long-term obligations	**(14,310)**	(16,417)	(15,907)
Payment of cash dividends	**(56,183)**	(52,682)	(46,883)
Proceeds from exercise of stock options	**29,405**	34,128	49,485
Repurchases of common stock	**(297,602)**	(209,295)	(29,687)
Other financing activities	**892**	(1,149)	(281)
Net cash used in financing activities	**(323,303)**	(245,415)	(43,273)
Net increase (decrease) in cash and cash equivalents	**(32,221)**	(113,069)	214,115
Cash and cash equivalents, beginning of year	**232,830**	345,899	131,784
Cash and cash equivalents, end of year	**$ 200,609**	$ 232,830	$ 345,899
Supplemental cash flow information:			
Cash paid during year for:			
Interest	**$ 25,747**	$ 26,748	$ 31,256
Income taxes	**$ 205,802**	$ 133,100	$ 165,248
Supplemental schedule of noncash investing and financing activities:			
Purchases of property and equipment awaiting processing for payment, included in Accounts payable	**$ 24,750**	$ 12,921	$ 9,643
Purchases of property and equipment under capital lease obligations	**$ 7,197**	$ 5,722	$ 996

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

1. Basis of presentation and accounting policies

Basis of presentation

These notes contain references to the years 2006, 2005, 2004 and 2003, which represent fiscal years ending or ended February 2, 2007, February 3, 2006, January 28, 2005 and January 30, 2004, respectively. Fiscal year 2006 will be, and each of 2004 and 2003 was, a 52-week accounting period while 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.

The Company leases four of its distribution centers ("DCs") from lessors, which meet the definition of a Variable Interest Entity ("VIE") as described by FASB Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"), as revised. Two of these DCs have been recorded as financing obligations whereby the property and equipment, along with the related lease obligations, are reflected in the consolidated balance sheets. The other two DCs, excluding the equipment, have been recorded as operating leases in accordance with SFAS No. 98, "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 7,929 stores (as of February 3, 2006) 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; and Jonesville, South Carolina. The Company also has a DC under construction in Marion, Indiana.

The Company purchases its merchandise from a wide variety of suppliers. Approximately 11% of the Company's purchases in 2005 were made from Procter and Gamble. No other supplier accounted for more than 3% of the Company's purchases in 2005.

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 and commercial paper. The carrying amounts of these items are a reasonable estimate of their fair value due to the short maturity of these investments.

Payments due from banks for third-party credit card, debit card and electronic benefit transactions ("EBT") classified as cash and cash equivalents totaled approximately $7.8 million and $4.8 million at February 3, 2006 and January 28, 2005, 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 $124.2 million and $112.3 million at February 3, 2006 and January 28, 2005, 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 existing credit facility.

The Company has certain cash and cash equivalents balances that are subject to restrictions and are 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 Statement of Financial Accounting Standards ("SFAS") No. 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. 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, such securities have been classified as held-to-maturity or available-for-sale. 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.

Beginning in fiscal year 2003, the Company began investing in 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.

In fiscal year 2005, the Company's South Carolina-based wholly owned captive insurance subsidiary, Ashley River Insurance Company ("ARIC"), had investments in U.S. Government securities, short and long-term corporate obligations, and asset backed obligations. These investments are held pursuant to South Carolina regulatory requirements to maintain 30% of ARIC's liability for insurance losses in the form of certain specified types of assets and as such, these investments are not available for general corporate purposes. At February 3, 2006, these investments included the following amounts reflected in the Company's consolidated balance sheet: cash and cash equivalents of $17.6 million, short-term investments of $8.9 million and long-term investments included in other assets of $16.9 million.

The Company's investment in the secured promissory notes issued by the third-party entity from which the Company leases its DC in South Boston, Virginia, as discussed in Note 7, has been classified as a held-to-maturity security. 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 3, 2006 and January 28, 2005, held-to-maturity, available-for-sale and trading securities consisted of the following (in thousands):

February 3, 2006	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Held-to-maturity securities				
Bank and corporate debt	**$ 59,196**	**$ –**	**$ 55**	**$ 59,141**
U.S. Government securities	**7,590**	**–**	**12**	**7,578**
Asset-backed securities	**3,847**	**5**	**6**	**3,846**
Other debt securities	**47,151**	**2,319**	**–**	**49,470**
	117,784	**2,324**	**73**	**120,035**
Available-for-sale securities				
Equity securities	**16,300**	**–**	**–**	**16,300**
Trading securities				
Equity securities	**14,873**	**–**	**–**	**14,873**
Total debt and equity securities	**$148,957**	**$ 2,324**	**$ 73**	**$151,208**

January 28, 2005	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Held-to-maturity securities				
Bank and corporate debt	$ 45,422	$ –	$ –	$ 45,422
Other debt securities	48,179	1,808	–	49,987
	93,601	1,808	–	95,409
Available-for-sale securities				
Equity securities	38,618	–	–	38,618
Other debt securities	42,425	–	–	42,425
	81,043	–	–	81,043
Trading securities				
Equity securities	11,932	–	–	11,932
Total debt and equity securities	$ 186,576	$ 1,808	$ –	$ 188,384

On February 3, 2006 and January 28, 2005, these investments were included in the following accounts in the consolidated balance sheets (in thousands):

February 3, 2006	Held-to-Maturity Securities	Available-for-Sale Securities	Trading Securities
Cash and cash equivalents	**$ 44,870**	**$ 16,300**	**$ –**
Short-term investments	**8,850**	**–**	**–**
Prepaid expenses and other current assets	**–**	**–**	**14,515**
Other assets, net	**16,913**	**–**	**358**
Current portion of long-term obligations (see Note 5)	**1,108**	**–**	**–**
Long-term obligations (see Note 5)	**46,043**	**–**	**–**
	$ 117,784	**$ 16,300**	**$ 14,873**
January 28, 2005			
Cash and cash equivalents	$ 44,922	$ 38,618	$ –
Short-term investments	500	42,425	–
Prepaid expenses and other current assets	–	–	11,932
Current portion of long-term obligations (see Note 5)	1,048	–	–
Long-term obligations (see Note 5)	47,131	–	–
	$ 93,601	$ 81,043	$ 11,932

The contractual maturities of held-to-maturity and available-for-sale securities as of February 3, 2006 were as follows (in thousands):

	Held-to-Maturity Securities		Available-for-Sale Securities	
	Cost	Fair Value	Cost	Fair Value
Less than one year	$ 53,638	$ 53,624	$ –	$ –
One to three years	13,929	13,877	–	–
Greater than three years	50,217	52,534	–	–
Equity securities	–	–	16,300	16,300
	$ 117,784	$ 120,035	$ 16,300	$ 16,300

For the years ended February 3, 2006, January 28, 2005, and January 30, 2004, 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. The excess of current cost over LIFO cost was approximately $5.8 million at February 3, 2006 and $6.3 million at January 28, 2005. Current cost is determined using the retail first-in, first-out method. LIFO reserves decreased $0.5 million and $0.2 million in 2005 and 2004, respectively, and increased $0.7 million in 2003. 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. The Company may adjust the net book value of the underlying assets based upon such cash flow analysis compared to the book value and may also consider appraised values. 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 of approximately $0.5 million and $0.6 million in 2004 and 2003, respectively, and $4.7 million prior to 2003 to reduce the carrying value of its Homerville, Georgia DC (which was sold in 2004). The Company also recorded impairment charges of approximately $0.6 million in 2005 and $0.2 million in each of 2004 and 2003 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. These charges are included in SG&A expense.

Other assets

Other assets consist primarily of long-term investments, debt issuance costs which are amortized over the life of the related obligations, utility and security deposits, life insurance policies and goodwill.

Vendor rebates

The Company records vendor rebates, primarily consisting of new store allowances, volume purchase rebates and promotional allowances, when realized. The rebates are recorded as a reduction to inventory purchases, at cost, which has the effect of reducing cost of goods sold, as prescribed by Emerging Issues Task Force ("EITF") Issue No. 02-16, "Accounting by a Customer (including a Reseller) for Certain Consideration Received from a Vendor".

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 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 in 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 in Accrued expenses and other in the consolidated balance sheets and totaled approximately $25.0 million

and $18.0 million at February 3, 2006 and January 28, 2005, respectively.

The Company recognizes contingent rental expense when the achievement of specified sales targets are considered probable, in accordance with EITF Issue No. 98-9, "Accounting for Contingent Rent." The amount expensed but not paid as of February 3, 2006 and January 28, 2005 was approximately $9.3 million and $8.6 million, respectively, and is included in Accrued expenses and other in the consolidated balance sheets. (See Notes 3 and 7).

Insurance reserves

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. Actuaries are utilized to determine the undiscounted future claim costs for the workers' compensation, general liability, and health claim risks. 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 subject to restrictions and 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. The Greater Cumberland Insurance Company, formerly a Vermont-based wholly owned captive insurance subsidiary of the Company, was liquidated in 2005.

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 3, 2006 and January 28, 2005, the fair value of the Company's debt, excluding capital lease obligations, was approximately $281.0 million and $275.9 million, respectively (net of the fair value of a note receivable on the South Boston, Virginia DC of approximately $49.5 million and $50.0 million, respectively, as further discussed in Note 7), based upon the estimated market value of the debt at those dates. Such fair value exceeded the carrying values of the debt at February 3, 2006 and January 28, 2005 by approximately $24.2 million and $32.7 million, respectively. Fair values are based primarily on quoted prices for those or similar instruments. A discussion of the carrying value and fair value of the Company's derivative financial instruments is included in the section entitled "Derivative financial instruments" below.

Derivative financial instruments

The Company accounts for derivative financial instruments in accordance with the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended by SFAS Nos. 137, 138 and 149 and interpreted by numerous Financial Accounting Standards Board ("FASB") Issues. These statements require the Company to recognize all derivative instruments on the balance sheet at fair value, and contain accounting rules for hedging instruments, which depend on the nature of the hedge relationship.

The Company has historically used derivative financial instruments primarily to reduce its exposure to adverse fluctuations in interest rates and, to a much lesser extent, other market exposures.

As a matter of policy, the Company does not buy or sell financial instruments, including derivatives, for speculative or trading purposes and all financial instrument transactions must be authorized and executed pursuant to the approval of the Board of Directors. All financial instrument positions taken by the Company are used to reduce risk by hedging an underlying economic exposure and are structured as straightforward instruments with liquid markets. The Company primarily executes derivative transactions with major financial institutions.

The following table summarizes activity in Accumulated other comprehensive loss during 2005 related to derivative transactions used by the Company in prior periods to hedge cash flow exposures relating to certain debt transactions (in thousands):

	Before-Tax Amount	Income Tax	After-Tax Amount
Accumulated net losses as of January 28, 2005	$ (1,539)	$ 566	$ (973)
Net losses reclassified from Other comprehensive loss into earnings	286	(107)	179
Accumulated net losses as of February 3, 2006	$ (1,253)	$ 459	$ (794)

The balance remaining in Accumulated other comprehensive loss at February 3, 2006 relates solely to deferred losses realized in June 2000 on the settlement of an interest rate derivative that was designated and effective as a cash flow hedge of the Company's forecasted issuance of its $200 million of fixed rate notes in June 2000 (see Note 5). This amount will be reclassified into earnings as an adjustment to the effective interest expense on the fixed rate notes through their maturity date in June 2010. The Company estimates that it will reclassify into earnings during the next twelve months approximately $0.2 million of the net amount recorded in Other comprehensive loss as of February 3, 2006.

Stock-based compensation

The Company has a shareholder-approved stock incentive plan under which stock options, restricted stock, restricted stock units and other equity-based awards may be granted to officers, directors and key employees. Prior to June 2003, the plan provided for automatic annual stock option grants to non-employee directors pursuant to a non-discretionary formula. Those stock options vested one year after the grant date and generally have a ten-year life.

Stock options currently are granted under this plan at the market price on the grant date and have a ten-year life subject to earlier termination upon death, disability or cessation of employment. Stock options granted under this plan (other than those granted to directors pursuant to the automatic grant provisions discussed above) generally vest ratably over a four-year period, with certain exceptions as further described in Note 9. However, on January 24, 2006, the Compensation Committee of the Company's Board of Directors accelerated the vesting of most of the Company's outstanding stock options as further described in Note 9.

The Company accounts for stock option grants in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25"), and related interpretations. Under APB No. 25, compensation expense is generally not recognized for plans in which the exercise price of the stock options equals the market price of the underlying stock on the date of grant and the number of shares subject to exercise is fixed. Had compensation cost for the Company's stock-based compensation plans been determined based on the fair value at the grant date for awards under these plans consistent with the methodology prescribed under SFAS No. 123 (with compensation expense amortized ratably over the applicable vesting periods), net income and earnings per share would have been reduced to the pro forma amounts indicated in the following table.

(Amounts in thousands except per share data)	2005	2004	2003
Net income – as reported	**$350,155**	$344,190	$299,002
Less pro forma effect of stock-based compensation cost, net of taxes	**32,621**	10,724	7,867
Net income – pro forma	**$317,534**	$333,466	$291,135
Earnings per share – as reported			
Basic	**$ 1.09**	$ 1.04	$ 0.89
Diluted	**$ 1.08**	$ 1.04	$ 0.89
Earnings per share – pro forma			
Basic	**$ 0.99**	$ 1.01	$ 0.87
Diluted	**$ 0.98**	$ 1.00	$ 0.86

The increase in the pro-forma stock-based compensation cost in 2005 was the result of the acceleration of the vesting of certain stock options as further discussed in Note 9. The decision to accelerate the vesting of stock options was made primarily to reduce non-cash compensation expense that would have been recorded in future periods following the adoption of SFAS No. 123(R) in the first quarter of fiscal year 2006.

As allowed by the stock incentive plans, the Company has historically extended the exercise period for outstanding stock option grants to three years from the date of cessation of employment with the Company for former employees who meet certain "early retirement" criteria which may include their age and years of service, to the extent that their stock options were fully vested at the date their employment ended. However, this practice does not extend the ten-year maximum contractual exercise term following the date of grant. Upon the adoption of SFAS No. 123(R), "Share-Based Payment" discussed below, the Company will be required to record compensation costs over the period through the date that such employees are no longer required to provide service to earn the award (generally, the first date that the employee is eligible to retire).

The Company may periodically award restricted stock or restricted stock units to officers and other key employees under the stock incentive plan. The terms of the stock incentive plan limit the total number of shares of restricted stock and restricted stock units eligible for issuance thereunder to a maximum of 4 million shares. Restricted stock awards consist of a fixed number of shares of common stock that generally vest ratably over three years. Restricted stock units represent the right to receive one share of common stock for each unit upon vesting and generally vest ratably over three years. In addition, the stock incentive plan was amended in June 2003 to provide

for the automatic annual grant of 4,600 restricted stock units to each non-employee director (6,000 restricted stock units to any non-employee director serving as Chairman) in lieu of the automatic annual stock option grants to directors discussed previously. The initial grant of these restricted stock units was made in 2004. These units generally vest one year after the grant date, subject to earlier vesting upon retirement or other circumstances described in the plan, but no payout shall be made until the individual has ceased to be a member of the Board of Directors. Dividends or dividend equivalents, as the case may be, are paid or accrued on the grants to officers and directors of restricted stock and restricted stock units at the same rate that dividends are paid to shareholders generally.

The Company accounts for restricted stock grants in accordance with APB No. 25 and related interpretations. Under APB No. 25, the Company calculates compensation expense as the difference between the market price of the underlying stock on the date of grant and the purchase price, if any, and recognizes such amount on a straight-line basis over the period in which the restricted stock award is earned by the recipient. The Company recognized compensation expense relating to its restricted stock awards of approximately \$2.4 million, \$1.8 million and \$0.4 million in 2005, 2004 and 2003, respectively (see Note 9).

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 returns and exclude sales tax. The reserve 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 is recorded in Accrued expenses and other.

Advertising costs

Advertising costs are expensed as incurred and were \$15.1 million, \$7.9 million and \$5.4 million in 2005, 2004 and 2003, respectively. These costs primarily related to targeted circulars supporting new stores and in-store signage. Additionally, beginning in 2005, the Company expanded its marketing and advertising efforts with the sponsorship of a National Association for Stock Car Auto Racing ("NASCAR") team.

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 \$3.3 million, \$3.6 million and \$0.2 million in 2005, 2004 and 2003, respectively.

Income taxes

The Company reports income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes." Under SFAS No. 109, the asset and liability method is used for computing 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.

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 December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 123(R), "Share-Based Payment," which will require an entity to measure compensation cost for all share-based payments (including grants of employee stock options) at fair value. The Company will adopt SFAS No. 123(R) during the first quarter of 2006 and expects to apply the standard using the modified prospective method, which requires compensation expense to be recorded for new and modified awards and also for unvested portions of previously issued and outstanding awards. The Company expects to incur incremental SG&A expense associated with the adoption of approximately \$5 million in 2006, dependent upon the number of grants and their related fair market values. See Stock-based compensation above for disclosure of the pro forma effects of stock option grants as determined using the methodology prescribed under SFAS No. 123.

SFAS No. 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost be reported as a financing cash flow, rather than as an

operating cash flow as required under current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. While the Company cannot estimate what those amounts will be in the future (because they depend on, among other things, when employees exercise stock options), the amounts of operating cash flows recognized in the accompanying consolidated statements of cash flows for such excess tax deductions were $6.5 million, $9.7 million and $14.6 million for 2005, 2004 and 2003, respectively.

On January 24, 2006, the Compensation Committee ("Committee") of the Company's Board of Directors approved the acceleration of vesting for 6.4 million of the Company's outstanding stock options awarded prior to August 2, 2005. The vesting acceleration was effective February 3, 2006. Vesting was not accelerated for stock options held by the CEO and stock options granted in 2005 to the officers of the Company at the level of Executive Vice President or higher. In addition, pursuant to that 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 higher, 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 stock options was made primarily to reduce non-cash compensation expense that would have been recorded in future periods following the adoption of SFAS No. 123(R) in the first quarter of fiscal year 2006. This action is expected to enable the Company to eliminate approximately $28 million of expense, before income taxes, over the four year period during which the stock options would have vested, subject to the impact of additional adjustments related to the forfeiture of certain stock options. The Company also believes this decision benefits employees. In connection with the acceleration and in accordance with the provisions of APB 25, the Company recorded compensation expense of $0.9 million, before income taxes, during 2005.

In March 2005, the FASB issued FASB Interpretation 47, "Accounting for Conditional Asset Retirement Obligations" ("FIN 47"), which is effective no later than the end of fiscal years ending after December 15, 2005. This Interpretation clarifies that the term conditional asset retirement obligation as used in FASB Statement No. 143, "Accounting for Asset Retirement Obligations", refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Thus, the timing and (or) method of settlement may be conditional on a future event. Accordingly, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. The fair value of a liability for the conditional asset retirement obligation should be recognized when incurred—generally upon acquisition, construction, or development and (or) through the normal operation of the asset. Uncertainty about the timing and (or) method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists. Statement 143 acknowledges that in some cases, sufficient information may not be available to reasonably estimate the fair value of an asset retirement obligation. This Interpretation also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. The Company adopted the provisions of FIN 47 during the fourth quarter of 2005, and such adoption did not have a material impact on the Company's consolidated financial statements as a whole.

Reclassifications

Certain reclassifications of the 2004 and 2003 amounts have been made to conform to the 2005 presentation.

2. Property and equipment

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

(In thousands)	2005	2004
Land and land improvements	**$ 147,039**	$ 145,194
Buildings	**381,460**	333,667
Leasehold improvements	**209,701**	191,103
Furniture, fixtures and equipment	**1,437,324**	1,196,094
Construction in progress	**46,016**	74,277
	2,221,540	1,940,335
Less accumulated depreciation and amortization	**1,029,368**	859,497
Net property and equipment	**$ 1,192,172**	$ 1,080,838

Depreciation expense related to property and equipment was approximately $186.1 million, $163.1 million and $150.9 million in 2005, 2004 and 2003, respectively. Amortization of capital lease assets is included in depreciation expense.

3. Accrued expenses and other

Accrued expenses and other consist of the following:

(In thousands)	2005	2004
Compensation and benefits	**$ 53,784**	$ 60,635
Insurance	**154,693**	130,506
Taxes (other than taxes on income)	**58,967**	45,005
Other	**105,476**	97,743
	$ 372,920	$ 333,889

Other accrued expenses primarily include liabilities for deferred rent, freight expense, contingent rent expense, interest, electricity, and common area maintenance charges.

4. Income taxes

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

(In thousands)	2005	2004	2003
Current:			
Federal	**$ 175,344**	$ 155,497	$ 145,072
Foreign	**1,205**	1,169	–
State	**9,694**	8,150	13,838
	186,243	164,816	158,910
Deferred:			
Federal	**8,479**	21,515	17,224
Foreign	**17**	21	–
State	**(252)**	4,215	1,387
	8,244	25,751	18,611
	$ 194,487	$ 190,567	$ 177,521

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

(Dollars in thousands)	2005		2004		2003	
U.S. federal statutory rate on earnings before income taxes	**$190,625**	**35.0%**	$ 187,165	35.0%	$166,783	35.0%
State income taxes, net of federal income tax benefit	**6,223**	**1.1**	8,168	1.5	10,773	2.3
Jobs credits, net of federal income taxes	**(4,503)**	**(0.8)**	(5,544)	(1.0)	(3,817)	(0.8)
Decrease in valuation allowances	**(88)**	**(0.0)**	(106)	(0.0)	(582)	(0.1)
Non-deductible penalty	**–**	**–**	–	–	3,500	0.7
Other	**2,230**	**0.4**	884	0.1	864	0.2
	$194,487	**35.7%**	$ 190,567	35.6%	$177,521	37.3%

While the 2005 and 2004 rates were similar overall, the rates contained offsetting differences. Non-recurring factors causing the 2005 tax rate to increase when compared to the 2004 tax rate include a reduction in federal jobs credits of approximately $1.0 million, additional net foreign income tax expense of approximately $0.8 million and a decrease in the contingent income tax reserve due to resolution of contingent liabilities that is $3.6 million less than the decrease that occurred in 2004. Non-recurring factors causing the 2005 tax rate to decrease when compared to the 2004 tax rate include the recognition of state tax credits of approximately $2.3 million related to the Company's construction of a distribution center in Indiana and a non-recurring benefit of approximately $2.6 million related to an internal restructuring that was completed during 2005.

The 2004 rate was lower than the 2003 rate primarily due to the reversal of certain contingent income tax liabilities of approximately $6.2 million in 2004, when the Company adjusted its tax contingency reserve based upon the results of two state income tax examinations. The tax rate in 2003 was negatively impacted by the $10.0 million penalty expense in 2003, related to the restatement of the Company's 2001 and earlier financial statements, which was not deductible for income tax purposes.

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)	2005	2004
Deferred tax assets:		
Deferred compensation expense	**$ 15,166**	$ 17,310
Accrued expenses and other	**3,916**	4,006
Accrued rent	**7,137**	4,883
Accrued insurance	**9,240**	25,950
Deferred gain on sale/leasebacks	**2,465**	2,624
Other	**3,712**	3,755
State tax net operating loss carryforwards, net of federal tax	**7,416**	9,180
State tax credit carryforwards, net of federal tax	**4,711**	1,982
	53,763	69,690
Less valuation allowances	**(2,038)**	(2,126)
Total deferred tax assets	**51,725**	67,564
Deferred tax liabilities:		
Property and equipment	**(74,609)**	(82,807)
Inventories	**(32,301)**	(31,635)
Other	**(536)**	(599)
Total deferred tax liabilities	**(107,446)**	(115,041)
Net deferred tax liabilities	**$ (55,721)**	$ (47,477)

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 income tax liabilities from the consolidated balance sheets:

(In thousands)	2005	2004
Current deferred income tax assets, net	**$ 11,912**	$ 24,908
Noncurrent deferred income tax liabilities, net	**(67,633)**	(72,385)
Net deferred tax liabilities	**$ (55,721)**	$ (47,477)

State net operating loss carryforwards as of February 3, 2006, totaled approximately $186 million and will expire beginning in 2006 through 2023. The Company also has state credit carryforwards of approximately $7.3 million that will expire beginning in 2006 through 2016.

The valuation allowance, as of 2005, has been provided principally for certain state tax credit carryforwards. In 2005, after an internal restructuring, all valuation allowances related to state net operating loss carryforwards were removed resulting in a reduction in the valuation allowance of approximately $1.1 million. This decrease was offset by additions to the valuation allowance applied to certain state tax credit carryforwards of approximately $0.9 million due to the same internal restructuring. The remaining change in the valuation allowance, an increase of approximately $0.1 million, related primarily to changes in state tax credits that were unrelated to the 2005 internal restructuring.

Approximately $1.0 million of the 2003 valuation allowance reduction was due to certain state tax law changes during the year which caused the future recognition of certain state tax credit carryforwards to be considered more likely than not to occur, thereby resulting in the reduction of a valuation allowance created in an earlier year. The change in the valuation allowance, including the changes noted above, was a decrease of $0.1 million, $0.1 million and $0.6 million in 2005, 2004, and 2003, respectively. 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 to realize the deferred tax assets after giving consideration to the valuation allowance.

The Company estimates its contingent income tax liabilities based on its assessment of probable income tax-related exposures and the anticipated settlement of those exposures translating into actual future liabilities. As of February 3, 2006 and January 28, 2005, the Company's accrual for these contingent liabilities, included in Income taxes payable in the consolidated balance sheets, was approximately $13.4 million and $13.5 million, respectively, and the related accrued interest included in Accrued expenses and other in the consolidated balance sheets was approximately $6.2 million and $6.9 million respectively.

As of February 3, 2006 and January 28, 2005, the Company had additional exposure in the amount of $3.8 million and $3.0 million, respectively, related to contingent income tax liabilities that had a reasonable possibility of being recognized as a loss in a future period. These additional amounts relate principally to income tax audits. As the Company does not consider it probable that a loss has yet been incurred related to these items, no portion of these liabilities has been recorded.

5. Current and long-term obligations

Current and long-term obligations consist of the following:

(In thousands)	February 3, 2006	January 28, 2005
8 5/8% Notes due June 15, 2010, net of discount of $189 and $232 at February 3, 2006 and January 28, 2005, respectively	**$ 199,789**	$ 199,768
Tax increment financing due February 1, 2035	**14,495**	–
Capital lease obligations (see Note 7)	**22,028**	28,178
Financing obligations (see Note 7)	**42,435**	43,376
	278,747	271,322
Less: current portion	**(8,785)**	(12,860)
Long-term portion	**$ 269,962**	$ 258,462

The Company's existing revolving credit facility (the "Credit Facility") has a current maximum commitment of $250 million and expires in June 2009. The Credit Facility contains provisions that would allow the maximum commitment to be increased to up to $400 million upon mutual agreement of the Company and its lenders. The Credit Facility is unsecured. The Company pays interest on funds borrowed under the Credit Facility at rates that are subject to change based upon the ratio of the Company's debt to EBITDA (as defined in the Credit Facility). The Company has two interest rate options, base rate (which is usually equal to prime rate) or LIBOR. Under the Credit Facility, the facility fees can range from 12.5 to 37.5 basis points; the all-in drawn margin under the LIBOR option can range from LIBOR plus 87.5 to 212.5 basis points; and the all-in drawn margin under the base rate option can range from the base rate plus 12.5 to 62.5 basis points. During 2005 and 2004, the Company had peak borrowings of $100.3 million and $73.1 million, respectively, under the Credit Facility. The Credit Facility contains financial covenants, which include limits on certain debt to cash flow ratios, a fixed charge coverage test, and minimum allowable consolidated net worth ($1.56 billion at February 3, 2006). As of February 3, 2006, the Company was in compliance with all of these covenants. As of February 3, 2006, the Company had no outstanding borrowings or standby letters of credit outstanding under the Credit Facility.

In July 2005, as an inducement for the Company to select Marion, Indiana as the site for construction of a new DC, the Economic Development Board of Marion approved a tax increment financing in the amount of $14.5 million. The principal amounts on this financing are due to be repaid during fiscal years 2015 to 2035. Pursuant to this financing, proceeds from the issuance of certain revenue bonds were loaned to the Company in connection with the construction of this DC. The variable interest rate on this loan is based on the weekly remarketing of the bonds, which are supported by a bank letter of credit, and ranged from 3.52% to 4.60% in 2005.

At February 3, 2006 and January 28, 2005, the Company had commercial letter of credit facilities totaling $195.0 million and $215.0, respectively, of which $85.1 million and $98.8 million, respectively, were outstanding for the funding of imported merchandise purchases.

In 2000, the Company issued $200 million principal amount of 8 5/8% Notes due June 2010 (the "Notes"). The Notes require semi-annual interest payments in June and December of each year through June 15, 2010, at which time the entire balance becomes due and payable. The Notes contain certain restrictive covenants. At January 28, 2005, the Company was in compliance with all such covenants.

6. Earnings per share

The amounts reflected below are in thousands except per share data.

	2005		
	Net Income	Weighted Average Shares	Per Share Amount
Basic earnings per share	**$350,155**	**321,835**	**$ 1.09**
Effect of dilutive stock options, restricted stock and restricted stock units		**2,298**	
Diluted earnings per share	**$350,155**	**324,133**	**$ 1.08**

	2004		
	Net Income	Weighted Average Shares	Per Share Amount
Basic earnings per share	$ 344,190	329,376	$ 1.04
Effect of dilutive stock options, restricted stock and restricted stock units		2,692	
Diluted earnings per share	$ 344,190	332,068	$ 1.04

	2003		
	Net Income	Weighted Average Shares	Per Share Amount
Basic earnings per share	$ 299,002	334,697	$ 0.89
Effect of dilutive stock options, restricted stock and restricted stock units		2,939	
Diluted earnings per share	$ 299,002	337,636	$ 0.89

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

Options to purchase shares of common stock that were outstanding at the end of the respective fiscal year, but were not included in the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common shares, were 7.9 million, 7.3 million and 5.1 million in 2005, 2004 and 2003, respectively.

7. Commitments and contingencies

As of February 3, 2006, the Company was committed under capital and operating lease agreements and financing obligations for most of its retail stores, four of its DCs, and certain of its furniture, fixtures and equipment. The majority of the Company's stores are subject to short-term leases (usually with initial or primary terms 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 between 7 and 10 years with multiple renewal options. Approximately half of the stores have provisions for contingent rentals based upon a percentage of defined sales volume. Certain leases contain restrictive covenants. As of February 3, 2006, the Company is not aware of any material violations of such covenants.

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 have been 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 are recorded in the consolidated balance sheets.

In May 2003, the Company purchased two secured promissory notes (the "DC Notes") from Principal Life Insurance Company totaling $49.6 million. The DC Notes represent debt issued by a third party entity from which the Company leases its DC in South Boston, Virginia. The DC Notes are being accounted for as "held to maturity" debt securities in accordance with the provisions of SFAS No. 115. However, by acquiring the DC Notes, the Company is holding the debt instruments pertaining to its lease financing obligation and, because a legal right of offset exists, has reflected the acquired DC Notes as a reduction of its outstanding financing obligations in its consolidated financial statements in accordance with the provisions of FASB Interpretation No. 39, "Offsetting of Amounts Related to Certain Contracts – An Interpretation of APB Opinion No. 10 and FASB Statement No. 105." There was no gain or loss recognized as a result of this transaction.

Future minimum payments as of February 3, 2006, for capital leases, financing obligations and operating leases are as follows:

(In thousands)	Capital Leases	Financing Obligations	Operating Leases
2006	$ 9,293	$ 9,283	$ 281,615
2007	5,895	9,564	235,959
2008	3,552	9,510	188,266
2009	1,302	8,915	149,196
2010	599	8,915	120,270
Thereafter	7,635	128,992	393,542
Total minimum payments	28,276	175,179	$1,368,848
Less: imputed interest	(6,248)	(85,593)	
Present value of net minimum lease payments	22,028	89,586	
Less: purchased promissory notes	–	(47,151)	
	22,028	42,435	
Less: current portion, net	(7,862)	(923)	
Long-term portion	$ 14,166	$ 41,512	

Capital leases were discounted at an effective interest rate of approximately 7.9% at February 3, 2006. The gross amount of property and equipment recorded under capital leases and financing obligations at February 3, 2006 and January 28, 2005, was $150.2 million and $183.8 million, respectively. Accumulated depreciation on property and equipment under capital leases and financing obligations at February 3, 2006 and January 28, 2005, was $70.5 million and $94.5 million, respectively.

Rent expense under all operating leases was as follows:

(In thousands)	2005	2004	2003
Minimum rentals	**$295,061**	$253,364	$217,704
Contingent rentals	**17,245**	15,417	14,302
	$312,306	$268,781	$232,006

Legal proceedings

On March 14, 2002, a complaint was filed in the United States District Court for the Northern District of Alabama *(Edith Brown, on behalf of herself and others similarly situated v. Dolgencorp. Inc., and Dollar General Corporation, CV02-C-0673-W ("Brown")). Brown* is a collective action against the Company on behalf of current and former salaried store managers claiming that these individuals were entitled to overtime pay and should not have been classified as exempt employees under the Fair Labor Standards Act ("FLSA"). Plaintiffs seek to recover overtime pay, liquidated damages, declaratory relief and attorneys' fees.

On January 12, 2004, the court certified an opt-in class of plaintiffs consisting of all persons employed by the Company as store managers at any time since March 14, 1999, who regularly worked more than 50 hours per week and either: (1) customarily supervised less than two employees at one time; (2) lacked authority to hire or discharge employees without supervisor approval; or (3) sometimes worked in non-managerial positions at stores other than the one he or she managed. The Company's request to appeal the certification decision on a discretionary basis to the 11th U.S. Circuit Court of Appeals was denied.

Notice was sent to prospective class members and the deadline for individuals to opt in to the lawsuit was May 31, 2004. Approximately 5,000 individuals opted in. Although the Company has several pending motions that may dispose of all or portions of the case, the Company is unable at this time to predict whether or the extent to which any of these motions will be successful. A trial date has not been set.

Three additional lawsuits, *Tina Depasquales v. Dollar General Corp.* (Southern District of Georgia, Savannah Division, CV 404-096, filed May 12, 2004), *Karen Buckley v. Dollar General Corp.* (Southern District of Ohio, C-2-04-484, filed June 8, 2004), and *Sheila Ann Hunsucker v. Dollar General Corp. et al.* (Western District of Oklahoma, Civ-04-165-R, filed February 19, 2004), were filed asserting essentially the same claims as the *Brown* case, and were subsequently consolidated in the Northern District of Alabama where the *Brown* litigation is pending. The plaintiffs in the *Depasquales* and the *Hunsucker* lawsuits have since dismissed their cases and opted into the *Brown* case. The *Buckley* plaintiff has represented to the Court an intent to abandon the federal FLSA claim in order to pursue a class action under Ohio's state law equivalent of the FLSA.

On October 10, 2005, the Company was served with an additional lawsuit, *Moldoon, et al. v. Dolgencorp, Inc., et al.* (Western District of Louisiana, Lake Charles Division, CV05-0852, filed May 19, 2005), filed as a putative collective action in which five current or former store managers claim to have been improperly classified as exempt executive employees under the FLSA. Plaintiffs seek injunctive relief, back wages, liquidated damages and attorneys' fees. Although the Company has answered the *Moldoon* complaint, discovery has not yet begun. At this time, it is not possible to predict whether the Court will permit this action to proceed collectively or whether the action will be consolidated with the *Brown* litigation.

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

On February 9, 2006, a complaint was filed in the United States District Court for the Western District of New York *(Tammy Brickey, Becky Norman, Rose Rochow, Sandra Cogswell and Melinda Sappington v. Dolgencorp, Inc. and Dollar General Corporation, Case 6:06-cv-06084-DGL ("Brickey")*. The *Brickey* plaintiffs seek to proceed collectively under the FLSA and as a class under New York and Ohio wage and hour statutes on behalf of, among others, individuals employed by the Company as Assistant Store Managers who claim to be owed wages (including overtime wages) under those statutes. As of March 16, 2006, the Company had not yet been served with the *Brickey* Complaint. At this time, it is not possible to predict whether the court will permit this action to proceed collectively or as a class. However, the Company believes that this action is not appropriate for either collective or class treatment, and believes that its wage and hour policies and practices comply with both federal and state law. Although the Company plans to vigorously defend this action if it is served, no assurances can be given that the Company will be successful in its defense on the merits or otherwise, and, if it is not, the resolution of this action could have a material adverse effect on the Company's financial statements as a whole.

On March 7, 2006, a complaint was filed in the United States District Court for the Northern District of Alabama *(Janet Calvert v. Dolgencorp, Inc., Case 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 ("EPA") and Title VII of the Civil Rights Act of 1964, as amended ("Title VII"). On March 9, 2006, the *Calvert* complaint was amended to include seven additional plaintiffs, who also allege to have been paid less than males because of their sex, and to add allegations of sex discrimination in promotional opportunities and undefined terms and conditions of employment. In addition to allegations of intentional sex discrimination, the amended *Calvert* complaint also alleges that the Company's employment policies and practices have a disparate impact on females. The amended *Calvert* complaint seeks to proceed collectively under the EPA and as a class under Title VII.

As of March 16, 2006, the Company had not yet been served with either the original or amended *Calvert* complaint. 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 case is not appropriate for either collective or class treatment, and believes that its policies and practices comply with the EPA and Title VII. Although the Company intends to vigorously defend this action if it is served, no assurances can be given that the Company will be successful in its defense on the merits or otherwise, and if it is not, the resolution of this action could have a material adverse effect on the Company's financial statements as a whole.

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

8. Benefit plans

The Dollar General Corporation 401(k) Savings and Retirement Plan became effective on January 1, 1998. Balances in two earlier plans were transferred into this plan. The plan covers all employees subject to certain eligibility requirements. The plan is subject to the Employee Retirement and Income Security Act ("ERISA").

Participants were or are currently permitted, as applicable, to contribute between 1% and 25% of their annual salary, up to a maximum of $12,000 in calendar year 2003, a maximum of $13,000 in calendar year 2004 and a maximum of $14,000 in calendar year 2005. Employees who are over age 50 were permitted to contribute an additional $4,000 in catch-up contributions during calendar year 2005. The Company currently matches employee contributions, including catch-up contributions, at a rate of 100% of employee contributions, up to 5% of annual 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 plan. During 2005, 2004 and 2003, the Company expensed approximately $5.8 million, $4.9 million and $2.7 million, respectively, for matching contributions.

The Company also has a supplemental retirement plan and compensation deferral 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 and 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. Effective January 1, 2003, the Company amended the plan to clarify certain provisions and to mirror certain 401(k) plan employer contribution provisions that became effective on January 1, 2003. Effective November 1, 2004, the plan document was amended to modify eligibility, comply with pending federal legislation, and enhance investment offerings. Effective January 1, 2005, the plan was amended to clarify certain provisions, to further comply with federal legislation and to permit former employees the ability to transfer stock accounts for a limited period of time. An employee may be designated for participation in one or both of the plans, according to the eligibility requirements of the plans. All participants are 100% vested in their compensation deferral plan accounts. Supplemental retirement plan accounts generally 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" or upon termination of employment due to death or "total and permanent disability" or upon a "change in control," all as defined in the plan. The Company incurred compensation expense for these plans of approximately $0.6 million in both 2005 and 2004 and $0.5 million in 2003.

The supplemental retirement plan and compensation deferral plan assets are invested at the option of the participant in either an account that mirrors the performance of a fund or funds selected by the Compensation Committee of the Company's Board of Directors or its delegate (the "Mutual Funds Option"), or in an account which mirrors the performance of the Company's common stock (the "Common Stock Option"). Pursuant to a provision in the November 1, 2004 amendment that was effective January 1, 2005, investments in the Common Stock Option cannot be subsequently diversified and investments in the Mutual Funds Option cannot be subsequently transferred into the Common Stock Option. Effective November 1, 2005, certain former employees who were receiving distributions from the plan were given a limited opportunity until January 31, 2006, to transfer assets out of the Common Stock Option.

In accordance with a participant's election, a participant's compensation deferral plan and supplemental retirement plan account balances will be paid in cash 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 lump sum distribution of vested amounts credited to the compensation deferral account, provided that the date of distribution is a date that is no sooner than five years after the end of the year in which amounts are deferred. In addition, a participant who is an employee may request to receive an "unforeseeable emergency hardship" in-service lump sum distribution of vested amounts credited to his compensation deferral account. Effective January 1, 2005 for active participants, account balances deemed to be invested in the Mutual Funds Option are payable in cash and account balances deemed to be invested in the Common Stock Option are payable in shares of Dollar General common stock and cash in lieu of fractional shares. Prior to January 1, 2005, all account balances were payable in cash.

Asset balances in the Mutual Funds Option are stated at fair market value, which is based on quoted market prices, and are included in Prepaid expenses and other current assets. 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 is recorded at historical cost and included in Other shareholders' equity. The deferred compensation liability related to the Company stock for active plan participants was reclassified to shareholders' equity and subsequent changes to the fair value of the obligation will not be recognized, in accordance with the provisions of EITF 97-14. The deferred compensation liability related to the Mutual Funds Option is recorded at the fair value of the investments held in the trust and is included in Accrued expenses and other in the consolidated balance sheets.

During 2003, the Company established two supplemental executive retirement plans, each with one executive participant. During 2004, one of these plans was terminated in connection with the termination of that participant's employment. The Company accounts for the remaining plan in accordance with SFAS No. 87, "Employers' Accounting for Pensions", as amended by SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits", and supplemented by SFAS No. 130, "Reporting Comprehensive Income", but has not included additional disclosures due to the plan's immateriality to the consolidated financial statements as a whole. Effective January 25, 2006, the Board approved the restatement of the remaining plan to clarify certain provisions, comply with pending federal legislation and establish a grantor trust to hold certain assets in connection with the plan. The grantor trust provides for assets to be placed in the trust upon an actual or potential change in control (as defined in the grantor trust). The assets of the grantor trust are subject to the claims of the Company's creditors.

Non-employee directors may defer all or a part of any fees normally paid by the Company to them pursuant 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 compensation deferred is credited to a liability account, which is then invested at the option of the director, in either the Mutual Funds Option or the Common Stock Option. In accordance with a director's election, the deferred compensation will be paid in a lump sum or in monthly installments over a 5, 10 or 15-year period, or a combination of both, at the time designated by the plan upon a director's resignation or termination from the Board. However, a director may request to receive an "unforeseeable emergency hardship" in-service lump sum distribution of amounts credited to his account in accordance with the terms of the directors' deferral plan. All deferred compensation will be immediately due and payable upon a "change in control" (as defined in the directors' deferral plan) of the

Company. Effective January 1, 2005, account balances deemed to be invested in the Mutual Funds Option are payable in cash and account balances deemed to be invested in the Common Stock Option are payable in shares of Dollar General common stock and cash in lieu of fractional shares. Prior to January 1, 2005, all account balances were payable in cash.

9. Stock-based compensation

The Company has a shareholder-approved stock incentive plan under which restricted stock, restricted stock units (which represent the right to receive one share of common stock for each unit upon vesting), stock options and other equity-based awards may be granted to officers, directors and key employees.

All stock options granted in 2005, 2004 and 2003 under the terms of the Company's stock incentive plan were non-qualified stock options issued at a price equal to the fair market value of the Company's common stock on the date of grant. Non-qualified options granted under these plans have expiration dates no later than 10 years following the date of grant.

Under the plan, stock option grants are made to key management employees including officers, as well as other employees, as determined by the Compensation Committee of the Board of Directors. The number of options granted is directly linked to the employee's job classification. Beginning in 2002, vesting provisions for options granted under the plan changed from a combination of Company performance-based vesting and time-based vesting to time-based vesting only. All options granted in 2005, 2004 and 2003 under the plan were originally scheduled to vest ratably over a four-year period, except for a grant made to the CEO in 2003, two-thirds of which vested after one year and one-third of which vested after two years.

On February 3, 2006, the vesting of all outstanding options granted prior to August 2, 2005, other than options previously granted to the CEO and other than options granted in 2005 to the officers of the Company at the level of Executive Vice President or higher, 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 higher, 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 stock options resulted in 2005 compensation expense of $0.9 million, before income taxes, and was made primarily to reduce non-cash compensation expense to be recorded in future periods under the provisions of SFAS No. 123(R), to be adopted by the Company during 2006. The future expense eliminated as a result of the decision to accelerate the vesting of options is 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 believes this decision benefits employees.

Under the plan, restricted stock and restricted stock units may be granted to employees, including officers, as determined by the Compensation Committee of the Board of Directors. In addition, the plan provides for the automatic annual grant of 4,600 restricted stock units to each non-employee director. In 2005, 2004 and 2003, the Company awarded a total of 273,600, 166,300 and 50,000 shares of restricted stock and restricted stock units to certain plan participants at weighted average fair values of $21.14, $19.26 and $19.37 per share, respectively. The difference between the market price of the underlying stock on the date of grant and the purchase price, which was set at zero for all restricted stock and restricted stock unit awards in 2005, 2004 and 2003, was recorded as unearned compensation expense, which is a component of Other shareholders' equity, and is being amortized to expense on a straight-line basis over the restriction period. The restricted stock and restricted stock units granted to employees in 2005, 2004 and 2003 under the plan generally vest and become payable ratably over a three-year period. The restricted stock units granted to outside directors generally vest one year after the grant date subject to acceleration of vesting upon retirement or other circumstances set forth in the plan, but no payout shall be made until the individual has ceased to be a member of the Board of Directors. Under the stock incentive plan, recipients of restricted stock are entitled to receive cash dividends and to vote their respective shares, but are prohibited from selling or transferring restricted shares prior to vesting. Recipients of restricted stock units are entitled to accrue dividend equivalents on the units but are not entitled to vote, sell or transfer the shares underlying the units prior to both vesting and payout. The maximum number

of shares of restricted stock or restricted stock units eligible for issuance under the terms of this plan has been capped at 4,000,000. At February 3, 2006, 3,510,841 shares of restricted stock or restricted stock units were available for grant under the plan.

During 2003, the Company also granted stock options and restricted stock in transactions that were not made under the stock incentive plan. The Company awarded 78,865 shares of restricted stock as a material inducement to employment to its CEO at a fair value of $12.68 per share. The difference between the market price of the underlying stock and the purchase price on the date of grant, which was set as zero for this restricted stock award, was recorded as unearned compensation expense, and is being amortized to expense on a straight-line basis over the restriction period of five years. The CEO is entitled to receive cash dividends and to vote these shares, but is prohibited from selling or transferring shares prior to vesting. Also during the first quarter of 2003, the Company awarded the CEO, as a material inducement to employment, an option to purchase 500,000 shares at an exercise price of $12.68 per share. The option generally vests at a rate of 166,666 shares on the second anniversary of the grant date and 333,334 shares on the third anniversary of the grant date, subject to accelerated vesting as provided in the CEO's Employment Agreement or in the plan. The option will terminate no later than 10 years from the grant date.

Pro forma information regarding net income and earnings per share, as disclosed in Note 1, has been determined as if the Company had accounted for its employee stock-based compensation plans under the fair value method of SFAS No. 123. The fair value of options granted during 2005, 2004 and 2003 was $6.33, $6.36 and $5.45, respectively. The fair value of each stock option grant was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	2005	2004	2003
Expected dividend yield	**0.9%**	0.9%	0.9%
Expected stock price volatility	**27.1%**	35.5%	36.9%
Weighted average risk-free interest rate	**4.2%**	3.5%	2.7%
Expected life of options (years)	**5.0**	5.0	3.7

A summary of the balances and activity for all of the Company's stock option awards for the last three fiscal years is presented below:

	Options Issued	Weighted Average Exercise Price
Balance, January 31, 2003	26,916,571	$ 15.73
Granted	4,705,586	18.39
Exercised	(4,240,438)	11.68
Canceled	(2,450,429)	17.76
Balance, January 30, 2004	24,931,290	16.75
Granted	2,250,900	18.88
Exercised	(2,874,828)	11.87
Canceled	(1,758,030)	18.97
Balance, January 28, 2005	22,549,332	17.42
Granted	**2,364,200**	**21.72**
Exercised	**(2,248,951)**	**13.07**
Canceled	**(2,406,257)**	**19.23**
Balance, February 3, 2006	**20,258,324**	**$ 18.19**

The following table summarizes information about all stock options outstanding at February 3, 2006:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$ 6.29 - $12.68	1,914,579	4.4	$ 11.11	1,581,245	$ 10.78
12.88 - 18.55	7,001,557	5.0	15.90	6,800,557	15.86
18.74 - 23.90	11,342,188	6.1	20.80	10,998,588	20.79
$ 6.29 - $23.90	20,258,324	5.6	$ 18.19	19,380,390	$ 18.24

At February 3, 2006, there were approximately 7.7 million shares available for grant under the Company's stock incentive plan. At January 28, 2005 and January 30, 2004, respectively, there were approximately 13.8 million and 15.0 million exercisable options outstanding.

10. Capital stock

The Company has a Shareholder Rights Plan (the "Plan"), filed with the Securities and Exchange Commission, 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, and will be attached to all additional shares of common stock issued prior to the Plan's expiration on February 28, 2010, or such earlier termination, if applicable. The Rights entitle the holders to purchase from the Company one one-hundredth of a share (a "Unit") of Series B Junior Participating Preferred Stock (the "Preferred Stock"), no par value, at a purchase price of $100 per Unit, subject to adjustment. Initially, the Rights will attach to all certificates representing shares of outstanding common stock, and no separate Rights Certificates will be distributed. The Rights will become exercisable upon the occurrence of a triggering event as defined in the Plan. The triggering events generally include any unsolicited attempt to acquire more than 15 percent of the Company's outstanding common stock. The practical operation of the Plan, if triggered, allows a holder of rights: (a) to acquire $200 of the Company's common stock in exchange for the $100 purchase price in the event of an acquisition of the Company in which the Company is the surviving entity; and (b) in the event of an acquisition of the Company in which the Company is not the surviving entity, to acquire $200 of the surviving entity's securities in exchange for the $100 purchase price.

On September 30, 2005, November 30, 2004 and March 13, 2003, the Board of Directors authorized the Company to repurchase up to 10 million, 10 million and 12 million shares, respectively, of its outstanding common stock. These authorizations allow or allowed, as applicable, 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 is to enhance shareholder value by purchasing shares at a price that produces a return on investment that is greater than the Company's cost of capital. Additionally, share repurchases generally are undertaken only if such purchases result in an accretive impact on the Company's fully diluted earnings per share calculation. The 2005 authorization expires September 30, 2006. The 2004 and 2003 authorizations were completed prior to their expiration dates. 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 the 2004 authorization at a total cost of $192.9 million. During 2004, the Company purchased approximately 0.5 million shares pursuant to the 2004 authorization at a total cost of $10.9 million and approximately 10.5 million shares pursuant to the 2003 authorization at a total cost of $198.4 million. During 2003, the Company purchased approximately 1.5 million shares pursuant to the 2003 authorization at a total cost of $29.7 million.

11. 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 3, 2006, 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 early 2004. The following data is presented in accordance with SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information."

(In thousands)	2005	2004	2003
Classes of similar products:			
Highly consumable	**$5,606,466**	$4,825,051	$4,206,878
Seasonal	**1,348,769**	1,263,991	1,156,114
Home products	**907,826**	879,476	860,867
Basic clothing	**719,176**	692,409	648,133
Net sales	**$8,582,237**	$7,660,927	$6,871,992

12. Quarterly financial data (unaudited)

The following is selected unaudited quarterly financial data for the fiscal years ended February 3, 2006 and January 28, 2005. With the exception of the fourth quarter of 2005, which was a 14-week accounting period, 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. Amounts are in thousands except per share data.

Quarter	First	Second	Third	Fourth
2005:				
Net sales	**$1,977,829**	**$2,066,016**	**$2,057,888**	**$2,480,504**
Gross profit	**563,349**	**591,530**	**579,016**	**730,929**
Operating profit	**106,921**	**121,070**	**101,612**	**232,264**
Net income	**64,900**	**75,558**	**64,425**	**145,272**
Basic earnings per share	**0.20**	**0.23**	**0.20**	**0.46**
Diluted earnings per share	**0.20**	**0.23**	**0.20**	**0.46**
2004:				
Net sales	$ 1,747,959	$ 1,836,243	$ 1,879,187	$ 2,197,538
Gross profit	512,250	536,980	553,985	659,977
Operating profit	114,550	108,126	113,956	220,344
Net income	67,849	71,322	71,126	133,893
Basic earnings per share	0.20	0.22	0.22	0.41
Diluted earnings per share	0.20	0.22	0.22	0.41

In 2005, the Company expanded the number of departments it utilizes for its gross profit calculation from 10 to 23. The estimated impact of this change was a reduction of the Company's net income and related per share amounts above of $2.1 million ($0.01 per diluted share), $2.2 million ($0.01 per diluted share) and $6.8 million ($0.02 per diluted share) in the first, second and third quarters of 2005, respectively, and a $7.7 million ($0.02 per diluted share) increase in the Company's fourth quarter 2005 net income and related per share amounts. The second quarter 2004 net income and related per share amounts above include a favorable income tax adjustment of approximately $6.2 million ($0.02 per diluted share) which resulted from net reductions in certain contingent income tax liabilities.

13. Guarantor subsidiaries

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

The following consolidating schedules present condensed financial information on a combined basis. Dollar amounts are in thousands.

	As of February 3, 2006			
	Dollar General Corporation	Guarantor Subsidiaries	Eliminations	Consolidated Total
BALANCE SHEET:				
ASSETS				
Current assets:				
Cash and cash equivalents	$ 110,410	$ 90,199	$ –	$ 200,609
Short-term investments	–	8,850	–	8,850
Merchandise inventories	–	1,474,414	–	1,474,414
Deferred income taxes	11,808	104	–	11,912
Prepaid expenses and other current assets	89,100	794,873	(816,833)	67,140
Total current assets	211,318	2,368,440	(816,833)	1,762,925
Property and equipment, at cost	199,396	2,022,144	–	2,221,540
Less accumulated depreciation and amortization	94,701	934,667	–	1,029,368
Net property and equipment	104,695	1,087,477	–	1,192,172
Other assets, net	2,379,255	31,603	(2,373,768)	37,090
Total assets	$2,695,268	$3,487,520	$(3,190,601)	$ 2,992,187
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities:				
Current portion of long-term obligations	$ (800)	$ 9,585	$ –	$ 8,785
Accounts payable	789,497	536,097	(817,208)	508,386
Accrued expenses and other	25,473	347,072	375	372,920
Income taxes payable	89	43,617	–	43,706
Total current liabilities	814,259	936,371	(816,833)	933,797
Long-term obligations	153,756	1,429,116	(1,312,910)	269,962
Deferred income taxes	6,458	61,175	–	67,633
Shareholders' equity:				
Preferred stock	–	–	–	–
Common stock	157,840	23,853	(23,853)	157,840
Additional paid-in capital	462,383	673,612	(673,612)	462,383
Retained earnings	1,106,165	363,393	(363,393)	1,106,165
Accumulated other comprehensive loss	(794)	–	–	(794)
Other shareholders' equity	(4,799)	–	–	(4,799)
Total shareholders' equity	1,720,795	1,060,858	(1,060,858)	1,720,795
Total liabilities and shareholders' equity	$2,695,268	$3,487,520	$(3,190,601)	$ 2,992,187

	As of January 28, 2005			
	Dollar General Corporation	Guarantor Subsidiaries	Eliminations	Consolidated Total
BALANCE SHEET:				
ASSETS				
Current assets:				
Cash and cash equivalents	$ 127,170	$ 105,660	$ –	$ 232,830
Short-term investments	42,425	500	–	42,925
Merchandise inventories	–	1,376,537	–	1,376,537
Deferred income taxes	10,024	14,884	–	24,908
Prepaid expenses and other current assets	23,305	1,740,029	(1,709,632)	53,702
Total current assets	202,924	3,237,610	(1,709,632)	1,730,902
Property and equipment, at cost	184,618	1,755,717	–	1,940,335
Less accumulated depreciation and amortization	78,661	780,836	–	859,497
Net property and equipment	105,957	974,881	–	1,080,838
Other assets, net	3,376,578	58,373	(3,405,687)	29,264
Total assets	$ 3,685,459	$ 4,270,864	$ (5,115,319)	$ 2,841,004
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities:				
Current portion of long-term obligations	$ 4,399	$ 8,461	$ –	$ 12,860
Accounts payable	1,763,024	355,904	(1,709,601)	409,327
Accrued expenses and other	37,378	296,511	–	333,889
Income taxes payable	–	69,647	(31)	69,616
Total current liabilities	1,804,801	730,523	(1,709,632)	825,692
Long-term obligations	190,769	1,261,998	(1,194,305)	258,462
Deferred income taxes	5,424	66,961	–	72,385
Shareholders' equity:				
Preferred stock	–	–	–	–
Common stock	164,086	23,853	(23,853)	164,086
Additional paid-in capital	421,600	1,243,468	(1,243,468)	421,600
Retained earnings	1,102,457	944,061	(944,061)	1,102,457
Accumulated other comprehensive loss	(973)	–	–	(973)
Other shareholders' equity	(2,705)	–	–	(2,705)
Total shareholders' equity	1,684,465	2,211,382	(2,211,382)	1,684,465
Total liabilities and shareholders' equity	$ 3,685,459	$ 4,270,864	$ (5,115,319)	$ 2,841,004

	For the year ended February 3, 2006			
	Dollar General Corporation	Guarantor Subsidiaries	Eliminations	Consolidated Total
STATEMENTS OF INCOME:				
Net sales	**$ 162,805**	**$ 8,582,237**	**$ (162,805)**	**$ 8,582,237**
Cost of goods sold	**–**	**6,117,413**	**–**	**6,117,413**
Gross profit	**162,805**	**2,464,824**	**(162,805)**	**2,464,824**
Selling, general and administrative	**139,879**	**1,925,883**	**(162,805)**	**1,902,957**
Operating profit	**22,926**	**538,941**	**–**	**561,867**
Interest income	**(31,677)**	**(509)**	**23,185**	**(9,001)**
Interest expense	**20,208**	**29,203**	**(23,185)**	**26,226**
Income before income taxes	**34,395**	**510,247**	**–**	**544,642**
Income taxes	**12,852**	**181,635**	**–**	**194,487**
Equity in subsidiaries' earnings, net of taxes	**328,612**	**–**	**(328,612)**	**–**
Net income	**$ 350,155**	**$ 328,612**	**$ (328,612)**	**$ 350,155**

	For the year ended January 28, 2005			
	Dollar General Corporation	Guarantor Subsidiaries	Eliminations	Consolidated Total
STATEMENTS OF INCOME:				
Net sales	$ 171,369	$ 7,660,927	$ (171,369)	$ 7,660,927
Cost of goods sold	–	5,397,735	–	5,397,735
Gross profit	171,369	2,263,192	(171,369)	2,263,192
Selling, general and administrative	138,111	1,739,474	(171,369)	1,706,216
Operating profit	33,258	523,718	–	556,976
Interest income	(6,182)	(393)	–	(6,575)
Interest expense	21,435	7,359	–	28,794
Income before income taxes	18,005	516,752	–	534,757
Income taxes	7,667	182,900	–	190,567
Equity in subsidiaries' earnings, net of taxes	333,852	–	(333,852)	–
Net income	$ 344,190	$ 333,852	$ (333,852)	$ 344,190

	For the year ended January 30, 2004			
	Dollar General Corporation	Guarantor Subsidiaries	Eliminations	Consolidated Total
STATEMENTS OF INCOME:				
Net sales	$ 169,467	$ 6,871,992	$ (169,467)	$ 6,871,992
Cost of goods sold	–	4,853,863	–	4,853,863
Gross profit	169,467	2,018,129	(169,467)	2,018,129
Selling, general and administrative	132,445	1,537,125	(169,467)	1,500,103
Penalty expense	10,000	–	–	10,000
Operating profit	27,022	481,004	–	508,026
Interest income	(3,720)	(383)	–	(4,103)
Interest expense	25,336	10,270	–	35,606
Income before income taxes	5,406	471,117	–	476,523
Income taxes	6,560	170,961	–	177,521
Equity in subsidiaries' earnings, net of taxes	300,156	–	(300,156)	–
Net income	$ 299,002	$ 300,156	$ (300,156)	$ 299,002

	For the year ended February 3, 2006			
	Dollar General Corporation	Guarantor Subsidiaries	Eliminations	Consolidated Total
STATEMENTS OF CASH FLOWS:				
Cash flows from operating activities:				
Net income	$ 350,155	$ 328,612	$ (328,612)	$ 350,155
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	20,046	166,778	–	186,824
Deferred income taxes	(750)	8,994	–	8,244
Tax benefit from stock option exercises	6,457	–	–	6,457
Equity in subsidiaries' earnings, net	(328,612)	–	328,612	–
Change in operating assets and liabilities:				
Merchandise inventories	–	(97,877)	–	(97,877)
Prepaid expenses and other current assets	(4,112)	(9,326)	–	(13,438)
Accounts payable	(26,052)	113,282	–	87,230
Accrued expenses and other	(12,210)	52,586	–	40,376
Income taxes	13	(26,030)	–	(26,017)
Other	5,817	7,714	–	13,531
Net cash provided by operating activities	10,752	544,733	–	555,485
Cash flows from investing activities:				
Purchases of property and equipment	(18,089)	(266,023)	–	(284,112)
Purchases of short-term investments	(123,925)	(8,850)	–	(132,775)
Sales of short-term investments	166,350	500	–	166,850
Purchases of long-term investments	–	(16,995)	–	(16,995)
Insurance proceeds related to property and equipment	–	1,210	–	1,210
Proceeds from sale of property and equipment	100	1,319	–	1,419
Net cash provided by (used in) investing activities	24,436	(288,839)	–	(264,403)
Cash flows from financing activities:				
Borrowings under revolving credit facility	232,200	–	–	232,200
Repayments of borrowings under revolving credit facility	(232,200)	–	–	(232,200)
Issuance of long-term obligations	–	14,495	–	14,495
Repayments of long-term obligations	(4,969)	(9,341)	–	(14,310)
Payment of cash dividends	(56,183)	–	–	(56,183)
Proceeds from exercise of stock options	29,405	–	–	29,405
Repurchases of common stock	(297,602)	–	–	(297,602)
Changes in intercompany note balances, net	276,509	(276,509)	–	–
Other financing activities	892	–	–	892
Net cash used in financing activities	(51,948)	(271,355)	–	(323,303)
Net decrease in cash and cash equivalents	(16,760)	(15,461)	–	(32,221)
Cash and cash equivalents, beginning of year	127,170	105,660	–	232,830
Cash and cash equivalents, end of year	$ 110,410	$ 90,199	$ –	$ 200,609

	For the year ended January 28, 2005			
	Dollar General Corporation	Guarantor Subsidiaries	Eliminations	Consolidated Total
STATEMENTS OF CASH FLOWS:				
Cash flows from operating activities:				
Net income	$ 344,190	$ 333,852	$ (333,852)	$ 344,190
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	17,181	147,297	–	164,478
Deferred income taxes	5,516	20,235	–	25,751
Tax benefit from stock option exercises	9,657	–	–	9,657
Equity in subsidiaries' earnings, net	(333,852)	–	333,852	–
Change in operating assets and liabilities:				
Merchandise inventories	–	(219,396)	–	(219,396)
Prepaid expenses and other current assets	652	(4,318)	–	(3,666)
Accounts payable	10,665	11,593	–	22,258
Accrued expenses and other	(8,351)	43,399	–	35,048
Income taxes	4,751	19,042	–	23,793
Other	(1,347)	(9,251)	–	(10,598)
Net cash provided by operating activities	49,062	342,453	–	391,515
Cash flows from investing activities:				
Purchases of property and equipment	(20,443)	(267,851)	–	(288,294)
Purchases of short-term investments	(220,200)	(1,500)	–	(221,700)
Sales of short-term investments	245,000	2,501	–	247,501
Proceeds from sale of property and equipment	3	3,321	–	3,324
Net cash provided by (used in) investing activities	4,360	(263,529)	–	(259,169)
Cash flows from financing activities:				
Borrowings under revolving credit facility	195,000	–	–	195,000
Repayments of borrowings under revolving credit facility	(195,000)	–	–	(195,000)
Repayments of long-term obligations	(7,847)	(8,570)	–	(16,417)
Payment of cash dividends	(52,682)	–	–	(52,682)
Proceeds from exercise of stock options	34,128	–	–	34,128
Repurchases of common stock	(209,295)	–	–	(209,295)
Changes in intercompany note balances, net	25,586	(25,586)	–	–
Other financing activities	(1,149)	–	–	(1,149)
Net cash used in financing activities	(211,259)	(34,156)	–	(245,415)
Net increase (decrease) in cash and cash equivalents	(157,837)	44,768	–	(113,069)
Cash and cash equivalents, beginning of year	285,007	60,892	–	345,899
Cash and cash equivalents, end of year	$ 127,170	$ 105,660	$ –	$ 232,830

	For the year ended January 30, 2004			
	Dollar General Corporation	Guarantor Subsidiaries	Eliminations	Consolidated Total
STATEMENTS OF CASH FLOWS:				
Cash flows from operating activities:				
Net income	$ 299,002	$ 300,156	$ (300,156)	$ 299,002
Adjustments to reconcile net income to net cash provided by (used in) operating activities:				
Depreciation and amortization	19,961	134,496	–	154,457
Deferred income taxes	(2,102)	20,713	–	18,611
Tax benefit from stock option exercises	14,565	–	–	14,565
Equity in subsidiaries' earnings, net	(300,156)	–	300,156	–
Change in operating assets and liabilities:				
Merchandise inventories	–	(34,110)	–	(34,110)
Prepaid expenses and other current assets	(7,323)	(8,981)	–	(16,304)
Accounts payable	(50,489)	83,754	–	33,265
Accrued expenses and other	15,752	44,771	–	60,523
Income taxes	4,079	(25,543)	–	(21,464)
Other	1,964	3,556	–	5,520
Net cash provided by (used in) operating activities	(4,747)	518,812	–	514,065
Cash flows from investing activities:				
Purchases of property and equipment	(15,526)	(124,613)	–	(140,139)
Purchases of short-term investments	(199,950)	(2,000)	–	(201,950)
Sales of short-term investments	132,725	2,000	–	134,725
Purchase of promissory notes	(49,582)	–	–	(49,582)
Proceeds from sale of property and equipment	39	230	–	269
Contribution of capital	(10)	–	10	–
Net cash used in investing activities	(132,304)	(124,383)	10	(256,677)
Cash flows from financing activities:				
Repayments of long-term obligations	(7,753)	(8,154)	–	(15,907)
Payment of cash dividends	(46,883)	–	–	(46,883)
Proceeds from exercise of stock options	49,485	–	–	49,485
Repurchases of common stock	(29,687)	–	–	(29,687)
Issuance of common stock, net	–	10	(10)	–
Changes in intercompany note balances, net	384,378	(384,378)	–	–
Other financing activities	(281)	–	–	(281)
Net cash provided by (used in) financing activities	349,259	(392,522)	(10)	(43,273)
Net increase in cash and cash equivalents	212,208	1,907	–	214,115
Cash and cash equivalents, beginning of year	72,799	58,985	–	131,784
Cash and cash equivalents, end of year	$ 285,007	$ 60,892	$ –	$ 345,899

Annual Meeting

Dollar General Corporation's annual meeting of shareholders is scheduled for 10 a.m. CDT on Wednesday, May 31, 2006, at:

Goodlettsville City Hall Auditorium
105 South Main Street
Goodlettsville, Tennessee, 37072

Shareholders of record as of March 27, 2006 are entitled to vote at the meeting.

Form 10-K; SEC and NYSE Certifications

A copy of the Form 10-K filed by the Company with the Securities and Exchange Commission (the "SEC") for the fiscal year ended February 3, 2006, which includes as exhibits the Chief Executive Officer and Chief Financial Officer Certifications required to be filed with the SEC pursuant to Section 302 of the Sarbanes-Oxley Act, is available on our Web site at www.dollargeneral.com under the Investing section or on the SEC's Web site. A printed copy of the Form 10-K, and a list of all its exhibits, will be supplied without charge to any shareholder upon written request. Exhibits to that Form 10-K are available for a reasonable fee. For a printed copy of the Form 10-K, please contact:

Dollar General Corporation
Investor Relations
100 Mission Ridge
Goodlettsville, Tennessee 37072
(615) 855-4000
www.dollargeneral.com

On May 26, 2005, the Company submitted to the New York Stock Exchange (the "NYSE") the Certification of its Chief Executive Officer confirming that the Company has complied with the NYSE corporate governance listing standards.

NYSE:DG

The common stock of Dollar General Corporation is traded on the New York Stock Exchange under the trading symbol "DG." The approximate number of shareholders of record of the Company's common stock as of March 27, 2006 was approximately 12,114.

Store Support Center / Corporate Headquarters

Dollar General Corporation
100 Mission Ridge
Goodlettsville, Tennessee 37072
(615) 855-4000
www.dollargeneral.com

Direct Stock Purchase/Dividend Reinvestment Plan

The Dollar General Direct Stock Purchase Plan is administered by the Company's transfer agent, Registrar and Transfer Company. To obtain enrollment materials, including the prospectus, call (888) 266-6785 or access the transfer agent's Web site, www.rtco.com.

Transfer Agent

Registrar and Transfer Company
P.O. Box 1010
Cranford, New Jersey 07016
(800) 368-5948
www.rtco.com

Inquiries regarding stock transfers, lost certificates or address changes should be directed to the transfer agent listed above.

Independent Registered Public Accounting Firm

Ernst & Young LLP
Nashville, Tennessee

Dividends and Stock Prices by Quarter

The following table sets forth the range of the high and low sales prices of the Company's common stock during each quarter in the Company's 2005 and 2004 fiscal years, as reported in the consolidated transaction reporting system, together with dividends.

2005	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
High	**$ 22.80**	**$ 22.50**	**$ 20.39**	**$19.84**
Low	**$ 19.83**	**$ 19.35**	**$ 17.75**	**$16.47**
Dividends	**$ .040**	**$ .045**	**$ .045**	**$ .045**

2004	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
High	$ 23.19	$ 20.60	$ 20.94	$ 21.29
Low	$ 18.07	$ 16.91	$ 17.69	$ 19.04
Dividends	$ .040	$ .040	$ .040	$ .040

The Company's stock price at the close of the market on March 27, 2006, was $17.67.

The Company has paid cash dividends on its common stock since 1975. The Board of Directors regularly reviews the Company's dividend plans to ensure that they are consistent with the Company's earnings performance, financial condition, need for capital and other relevant factors.

Board of Directors

David L. Beré(2)
Former President and CEO
Bakery Chef, Inc.

Dennis C. Bottorff(3)*(4)
Chairman
Council Ventures, LLC

Barbara L. Bowles(3)(4)*
Vice Chairman
Profit Investment Management

James L. Clayton(2)
Chairman and CEO
Clayton Bancorp, Inc.

Reginald D. Dickson(2)
Chairman and CEO
Buford, Dickson, Harper
and Sparrow, Inc.

E. Gordon Gee(2)*
Chancellor
Vanderbilt University

Barbara M. Knuckles(1)
Managing Director
North Central College

David A. Perdue
Chairman and CEO
Dollar General Corporation

J. Neal Purcell(1)
Retired Partner
KPMG LLP

James D. Robbins(1)*
Retired Partner
PricewaterhouseCoopers L.L.P.

David M. Wilds(3)(4)
Managing Partner
1st Avenue Partners, L.P.

(1) Audit Committee
(2) Compensation Committee
(3) Nominating and Corporate Governance Committee
(4) Finance Committee
(*) Committee Chairman

Board of Directors: *Left to right, back row: James D. Robbins, J. Neal Purcell, David L. Beré, James L. Clayton, Barbara L. Bowles, David A. Perdue, Dennis C. Bottorff, Reginald D. Dickson, David M. Wilds. Left to right, front row: Barbara M. Knuckles, E. Gordon Gee.*

Corporate Officers

David A. Perdue
Chairman and
Chief Executive Officer

Beryl J. Buley
Division President,
Merchandising, Marketing and
Supply Chain

Kathleen R. Guion
Division President,
Store Operations and
Store Development

David M. Tehle
Executive Vice President and
Chief Financial Officer

Susan S. Lanigan
Executive Vice President and
General Counsel

Challis M. Lowe
Executive Vice President,
Human Resources

Gayle Aertker
Senior Vice President,
Real Estate and
Store Development

J. Bruce Ash
Senior Vice President and
Chief Information Officer

Rita F. Branham
Senior Vice President and
General Merchandise Manager,
Consumables

Lloyd Davis
Senior Vice President,
Global Supply Chain

Anita C. Elliott
Senior Vice President and
Controller

Wayne Gibson
Senior Vice President,
Dollar General Markets

Penny Katsaros
Senior Vice President,
Store Operations

Tom Mitchell
Senior Vice President,
Store Operations

Jeffrey R. Sims
Senior Vice President,
Distribution

Dollar General carries its commitment to serve others deep into the communities it calls home and into the world. When a history-making tsunami struck Southeast Asian villages in late 2004, Dollar General reached out to thousands by funding efforts to help children displaced by the storm. When disaster struck closer to home with the force of Hurricane Katrina, Hurricane Rita and Hurricane Wilma, Dollar General again reached out to help the recovery effort. In 2005, we launched an employee assistance fund to help co-workers cope with the loss of an immediate family member or the loss of their home. We also helped fund the American Breast Cancer Foundation's financial assistance efforts for uninsured or underinsured individuals in need of breast cancer screenings or treatment. And, as we have for years, we reached neighbors in our operating area by supporting local programs that offer the life-changing gift of literacy. In 2005 alone, we touched more than 88,000 lives through Dollar General Literacy Foundation grants and our in-store learn-to-read referral program.

DOLLAR GENERAL®

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Goodlettsville, TN 37072
www.dollargeneral.com