



P.E.  
8/27/05

REC'D 9.28.05  
DEC 1 2005  
1055

ARLS

Family Dollar Stores Inc 1-6807

value

PROCESSED  
DEC 07 2005  
THOMSON  
FINANCIAL

**Corporate Profile.** Family Dollar Stores, Inc., operates a chain of almost 6,000 retail discount stores in 44 states. We have provided value-conscious consumers with competitive prices in our neighborhood stores for more than 46 years. Our stores offer a core assortment of name-brand and daily consumable merchandise supplemented by fashion and seasonal merchandise at everyday low prices in a convenient, self-service shopping environment. Most merchandise is priced under \$10.00.

Family Dollar is one of the fastest growing retail chains in the United States. During the last five years, we have opened nearly 2,200 new stores, including 500 that were opened during the year ended August 27, 2005.

Family Dollar operates small stores, generally ranging in size from 7,500 to 9,500 square feet, and most are operated in leased facilities. The relatively small store size permits the Company to operate in rural, small town, suburban and urban areas. Within these markets, stores are located in shopping centers, freestanding buildings or in urban storefronts convenient to the Company's value-conscious customer base.

The Company has been a publicly held corporation since 1970, and its Common Stock is listed on the New York Stock Exchange under the ticker symbol FDO.



At the heart of Family Dollar's mission is the determination to provide exceptional value to the people who are the most important to us — our Shareholders, our Customers and our Associates.

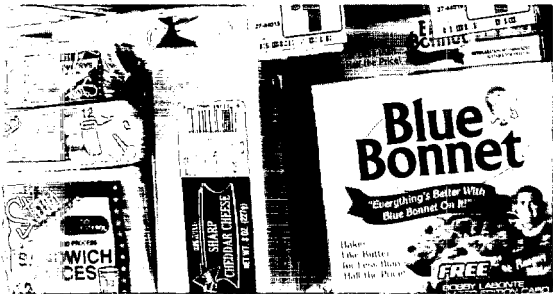
**The Cooler Initiative:** Our stores provide value and convenience to our Customers through an expanded food assortment, which includes refrigerated coolers for those frequent 'milk and eggs' fill-in trips. Offering family staples in both perishable and non-perishable foods keeps our Customers coming back day after day.

**The Urban Initiative:** The Urban Initiative addresses the opportunities and challenges of operating in urban markets. Better Customer service and store presentation standards, a more flexible organizational structure and improved processes drive higher financial performance, creating value for our Shareholders, our Customers and our Associates.

**The Treasure Hunt Initiative:** Our Customers appreciate the tremendous value we deliver by offering both exciting and unique Treasure Hunt items, as well as our everyday home and family necessities that they count on.

**The New Store Initiative:** By expanding into new areas and increasing our presence in existing markets, our stores provide value and neighborhood convenience to one of the fastest growing, yet vastly under-served consumer segments.

**Our Associates:** Family Dollar's most valuable asset is our team of talented and dedicated Associates. We are committed to providing the skills and development tools to allow our Associates to build not just a job, but a career with us.



# To Our Shareholders



As a fellow Shareholder, this is a difficult letter to write. While we achieved a record \$5.8 billion in sales in fiscal 2005, a 10.3% increase above 2004, net income was \$217.5 million, a decrease of 15.7% — our first decline in earnings since 1995. Despite these disappointing financial results, I am more excited than ever about our Company's future prospects and our ability to create value for our Customers, for our Associates, and for you, our Shareholders.

We now operate approximately 6,000 stores, and we believe there is ample opportunity to grow the size of our chain to better serve our expanding customer base. New geographical markets like California remain future growth opportunities, and our Urban Initiative creates additional store expansion opportunities in large metropolitan markets, which are largely under-served by other retailers. Our target Customer, the low and lower-middle income population, has experienced significant growth. Over the last five years, the number of people making less than \$25,000 in annual household income has increased more than ten percent, and the number of families with income below the poverty level has grown almost eight percent. Clearly, an increasing number of people need the values that Family Dollar offers.

As I reflect on our performance in 2005, I believe that two factors affected our results: a challenging economic environment and an aggressive investment agenda.

First, while our operational performance can always be better, the economic environment for our low and lower-middle income Customer was challenging last year.

The average cost of gasoline continued to soar in 2005, capturing a larger share of our Customers' already strained budgets. As energy costs increased, our Customers had less disposable income and bought fewer discretionary items. In response, we continued to increase the value and selection of basic consumable merchandise, like perishable food, so that

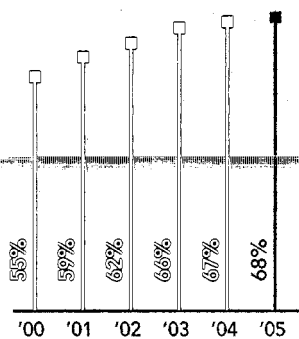
we could capture a larger portion of our Customers' limited wallet.

Second, we invested aggressively in our business to deliver greater long-term value for our Customers, our Associates and our Shareholders. During our 46-year history, we have made significant investments that affected short-term results but ultimately delivered long-term gains. For example, in 1995, we made strategic investments in support of our everyday low pricing strategy which had an adverse impact on our financial results that year — net income declined 7.9%. Although not as quantifiable then, the long-term benefits are now clear: our Customers benefited from lower prices, our Associates benefited from less complicated merchandising strategies, and our earnings grew at a double-digit rate in the ensuing years.

During 2005, we again made significant investments in our business to create greater value for our Customers, our Associates, and our Shareholders. To drive higher sales and stronger profitability in both bullish and bearish economic environments, we invested in four strategic initiatives last year: the installation of refrigerated coolers for the sale of perishable food; the Urban Initiative; our Treasure Hunt merchandise program; and new stores. We remain confident that these initiatives create a strong foundation for our future growth. But that doesn't mean that every initiative performed equally well. In 2006, we will increase investment in those initiatives that performed well in 2005 to drive additional returns, and we will refine and enhance initiatives that have not yet met our expectations, so that we may accelerate investment for higher returns in the future.

We are positioning Family Dollar to satisfy those fill-in food shopping trips that our Customers make frequently. At the beginning of 2005, we had planned to install refrigerated coolers for the sale of perishable food in 500 stores. However, our Customers reacted so quickly and positively to the program that we doubled our initial plan and installed

Percentage of Consumer Households that Shopped in a Dollar Store



Source: ACNielsen Homescan Consumer Insights 2005

We are committed to delivering **value** to our Shareholders, our Customers and our Associates as we position Family Dollar for future profitable growth.

refrigerated coolers in about 1,000 stores last year. This year we will expand the rollout to an additional 2,500 stores, and by the end of 2006, more than half of our chain will have refrigerated coolers.

In 2005, we launched our Urban Initiative in 1,200 stores to address the unique challenges of operating high-volume stores in large metropolitan markets. The Urban Initiative is designed to increase profitability in these markets through investments in people, process changes and technology, including organizational changes to support a more mobile and flexible workforce. While stores in the Urban Initiative experienced higher than average sales growth and continued to be profitable, the program did not achieve our profitability goals in 2005. We will continue to invest in the current Urban Initiative markets in 2006, but we will not expand the program into new markets until we have refined processes and generated expected results.

We experienced one of our strongest holiday seasons ever in 2005, generating comparable store sales increases of 5% in November and 4% in December. The addition of exciting Treasure Hunt merchandise drove these results as our Customers were delighted to find unexpected holiday "treasures" at Family Dollar. We will expand our Treasure Hunt merchandise program in 2006 to include more surprises for our Customers, better in-store presentations and improved merchandise allocations to stores to drive higher inventory turns.

In 2005, we continued our aggressive store expansion program with the opening of 500 new stores, but the timing of new store openings was weighted heavily toward the end of the fiscal year, increasing costs and operational inefficiencies. While we will maintain our commitment to new store growth with plans to open about 400 new stores in 2006, this slower rate of growth will allow us to focus on building processes to support an even distribution of store openings throughout the year. Creating a more steady flow

of new store openings will enable us to more efficiently accelerate our growth in the future.

We continue to build our management team with strong talent to support our growth opportunity. Some excellent new players have joined our talented team of seasoned veterans, and we have realigned our senior management structure to better support our cross-functional strategic agenda. As I assess Family Dollar today, I believe that we have a strong, cohesive team, and our new management alignment is having a tangible impact on our results.

In the fourth quarter of 2005, our Board of Directors authorized the repurchase of \$300 million of the Company's Common Stock. In September 2005, we took advantage of a compelling stock price and a favorable interest rate environment to repurchase ten million shares of Family Dollar Common Stock using proceeds of a \$250 million private placement of long-term debt. The issuance of debt when combined with the stock repurchase program will enhance Shareholder value while continuing to maintain a strong financial position.

Fiscal 2005 was a challenging year, but, thanks to the hard work of all of our Associates, we made significant progress in building the foundation upon which we intend to increase our market share and profitability. I remain excited about the growth opportunity that exists for our Company, and I am confident in our ability to realize this opportunity and deliver value to our Customers, our Associates, and you, our Shareholders.

*Howard R. Levine*

HOWARD R. LEVINE  
CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER  
November 2005

Milk. Eggs. Bread. These are the basics of every family's pantry and are replenished more often than any other food items. They are the core of our expanded food strategy. While many of our Customers make larger stock-up trips to refill their pantries, they also fit in more than 40 trips a year to pick up a gallon of milk or to buy more snacks for their children's lunches. We have expanded our food assortment to provide Customers with more neighborhood convenience and value for these frequent fill-in trips.

Low and lower-middle income consumers spend a significant portion of their limited budgets on food. While Family Dollar doesn't intend to be a full-service grocery store, we will satisfy the fill-in food trip needs of our Customers by offering a variety of ready-to-eat and quick preparation foods for breakfast, lunch, dinner and snack time. With limited budgets and cabinet space, busy moms like Gloria, who need to pick up milk and cereal for breakfast or bread and sandwich meat for lunch, know they can count on us for value and convenience.

As a result of enthusiastic and immediate Customer response expressed through increased traffic and sales, we accelerated our refrigerated cooler program and installed coolers in about 1,000 of our stores in 2005. While some of the sales increases are a direct result of sales of new cooler items, we have leveraged the additional traffic to increase sales in other departments, resulting in larger Customer purchases that include both perishable food and other items.

In 2006, we will install refrigerated coolers in approximately 2,500 additional stores, and by the end of our fiscal year, we will have coolers in more than half our chain. Ultimately, we expect to install refrigerated coolers in almost all of our stores. Offering everyday food necessities will keep our Customers coming back to Family Dollar day in and day out.



"Family Dollar always has just what I need. My family and I value both the savings and the convenience."

Gloria and Kyla,  
Family Dollar Customers





## The Urban Initiative

Urban markets represent a significant opportunity to provide under-served consumers with value and neighborhood convenience. Two-thirds of all consumer spending occurs in the largest 50 metropolitan markets, and inner city urban areas tend to be the most under-served retail space. Yet, while urban markets offer great opportunities, they also present great operating challenges. Our stores in urban markets serve more Customers and produce higher sales than stores in smaller towns, creating a greater velocity of products and people that is more difficult to manage. Available retail space is often older, smaller and has more restrictive delivery and transportation conditions due to city ordinances and physical location. Higher crime, inventory shrinkage risks and operating costs, including labor, rent and other expenses, make it more challenging to operate profitably in urban markets. Despite these obstacles, we believe the opportunities in urban markets outweigh these challenges.

To address these challenges and drive higher financial returns, we have developed the Urban Initiative. The Urban Initiative is designed to improve the consistency of customer service and operations and drive higher financial performance through investments in people, process changes and technology. To respond to the fast-changing dynamics of the urban market, we created a mobile and flexible Store Operations organization focused on managing by market areas, rather than operating each store individually. Talented, experienced store

teams drive our success in these markets, and we have enhanced our training programs and leveraged technology to create a pipeline of qualified urban store management candidates in anticipation of predicted personnel needs. We have improved store presentation standards and customer service, and we have implemented new loss prevention technology and procedures to address elevated inventory shrinkage in urban locations.

To address the higher costs inherent in operating in urban markets, we are implementing a price optimization strategy that enables us to provide Customers with competitive prices on their everyday needs but also allows us to partially offset the impact of operating in these more expensive markets. We are also improving our supply chain to address the challenges of producing increased sales and inventory turns within the limited space common in urban stores.

In 2005, we implemented the Urban Initiative in 1,200 stores in major urban markets. While we have increased our investment in these stores, we have also increased the sales. The marginal contribution of the incremental sales is now offsetting the incremental cost, but our goal is to create even more value for our Shareholders. In 2006, we plan to make dynamic adjustments to the existing program to drive further performance improvement, producing additional value for our Shareholders, our Customers and our Associates.



"I am proud  
to manage a  
store where we  
bring value to  
Customers in  
my community."

Ernie and Wanda,  
Family Dollar Associates



**FAMILY DOLLAR**



## The Treasure Hunt Initiative

Our Customers tell us that they need the household items that we consistently provide at our great, everyday low prices. But they also tell us how much they love finding unexpected “treasures” that add excitement and “WOW!” to their shopping trips.

While we continue to provide more value for our Customers by adding brand name, basic consumable merchandise to our assortment, we also are increasing our selection of exciting Treasure Hunt merchandise. Through opportunistic purchases and global sourcing, our merchants are creating a steady stream of unique and compelling values for Customers. Fun Treasure Hunt merchandise is offered in almost every department so that a tired mom can put a smile on her child’s face with a new toy or her own with a trendy knickknack to add some spark to her living room. As you can see on the next page, even our littlest Customers are delighted by our merchandise, and Brock’s mom is pleased by the great value she gets for her dollar.

Treasure Hunt merchandise affords us an additional opportunity to improve our in-store presentation and merchandise profitability. Our store Associates are excited to offer their Customers an ever-changing selection of seasonal and stylish merchandise at great values, and our logistical specialists are improving their ability to get the right quantities to the right stores at the right time so we can maximize sales and minimize markdowns. Everyday low pricing continues to be the foundation of our merchandise and pricing

strategies. Advertising circulars help us tell our Customers about the great everyday values in both Treasure Hunt and basic consumable merchandise.

We began offering our Treasure Hunt merchandise program to our Customers during the 2004 holiday season. Our Customers responded favorably, and our holiday sales were better than the economic conditions would have predicted. This year, we will build upon last year’s successful holiday season by providing additional Treasure Hunt values to keep the Family Dollar shopping experience surprising, fresh and compelling.

Our refrigerated cooler program and Urban Initiative drive more traffic into our stores as Customers seek great values on basic consumable merchandise, which generally has low profit margins. We intend to leverage these Customer trips by offering exciting, unexpected “treasures” with higher profit margins, in addition to our excellent values offered on everyday consumables.

While the focus of our Treasure Hunt items thus far has been fashion accessories, giftware and seasonal merchandise, we intend to expand our Treasure Hunt assortment into other categories to increase the total value proposition that we offer to our Customers.



"My son thinks your toys are the coolest. I just think they're an amazing value."  
Heather and Brock, Family Dollar Customers

Our small stores provide value and neighborhood convenience to low and lower-middle income consumers, one of the fastest growing population segments in the U.S. During the last five years, the number of households with annual income below \$25,000 has increased more than ten percent, and the number of families with income below the poverty level has grown almost eight percent. To address this under-served population, we have aggressively opened new stores to provide more value and convenience to this growing customer base.

To maximize the return on our investment, we don't place new Family Dollar stores in the first empty lot we see or in any retail strip center with available space. Sophisticated evaluation processes and technology ensure that new Family Dollar stores are advantageously located in the neighborhoods of our Customers, providing convenient shopping for their everyday needs. Advanced modeling techniques help us predict which neighborhoods will provide us with the best opportunity for sales and profitability. We consider many variables in deciding where to locate a store, including customer demographics and site attributes such as traffic patterns, visibility and accessibility, as well as the overall projected financial return compared to the cost of the investment.

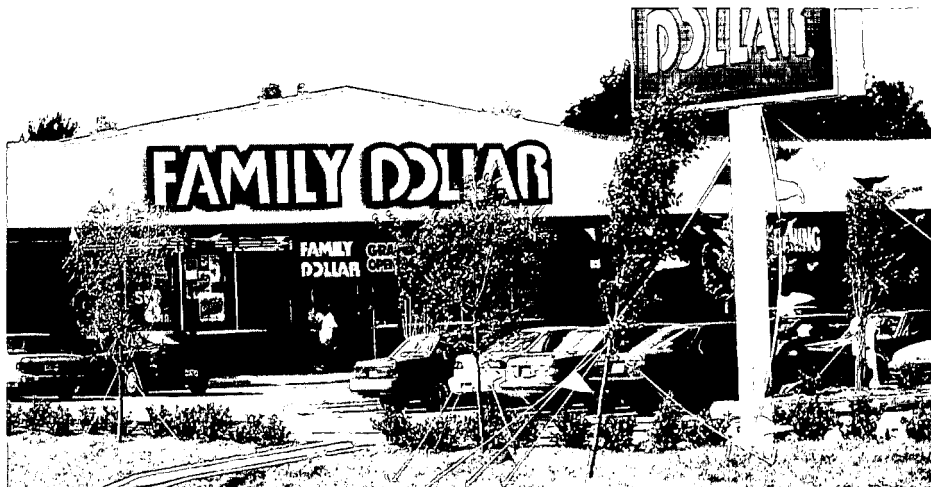
New stores not only increase our sales as we serve new Customers, but also create valuable development opportunities for Family Dollar Associates. In fact, in 2005 many of our new store managers were promoted from within our organization. At right, Patty, a dedicated Family Dollar Store Manager, arranges a festive holiday presentation to build excitement for her Customers during Grand Opening Day at the new store she will manage.

In 2005, we opened 500 new stores. However, with a large number of those new stores opened in the last two months of the fiscal year, we created unnecessary cost and operational inefficiencies. To create more value for our Shareholders, we will slow our new store growth to about 400 stores in 2006 and build processes that support a more balanced schedule of store openings. Creating a more steady flow of new store openings will enable us to more efficiently accelerate our growth in the future, creating greater value for our Shareholders, our Customers and our Associates.



"Opening new stores is just one way we serve our expanding Customer base and bring value to our Shareholders."

Patty, Family Dollar Store Manager





## Our Associates

Family Dollar's Associates are our greatest competitive advantage and our most valuable asset. We employ more than 42,000 hard-working and talented Associates in our stores, distribution centers and corporate offices. But at Family Dollar, we're not satisfied with creating and providing jobs; we're committed to building careers. The Company's financial stability and growth opportunities attract top candidates to the Company; training, defined career paths and significant potential for advancement keep them here.

Our success begins with recruiting. In 2005, we created a significant number of new jobs to support our growth. We opened 500 new stores, creating more than 3,000 jobs primarily in the neighborhoods where our Customers live. We opened our eighth distribution center in Marianna, Florida, creating more than 400 new positions, such as the one filled by Brian in the shipping department. In 2006, with the opening of our ninth distribution center in Rome, New York, we will create additional career opportunities. To support our aggressive growth agenda, we have developed end-to-end technology applications that have improved our recruiting, screening and selection processes.

One of our top priorities is to provide our Associates with a compelling place to work. To achieve this objective, we have invested in building career paths for each position to create development choices for those Associates who wish to grow in their careers with the Company. Here at Family Dollar, we prefer to promote talented Associates from within. To support these efforts, we offer focused training and professional development programs that allow Associates to progress up the Family Dollar career ladder.

To attract and retain talented Associates, we must offer equitable and competitive compensation. During the last several years, we have partnered with a leading compensation consultant to review and improve our compensation programs. In 2006, we have asked our Shareholders to approve equity-based compensation programs that are based on pay for performance principles. These new compensation programs will better support our efforts to recruit and retain talented Associates who will help us realize Family Dollar's growth opportunity.

Our dedicated training programs, career growth and advancement opportunities and equitable compensation programs will help us hire and retain talented Family Dollar Associates and will drive higher returns for Shareholders.



"The opportunities that Family Dollar offers let me know they **value** me as an Associate."

Brian - Family Dollar Distribution Center Associate



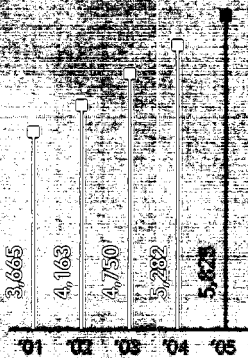
Family Dollar Stores, Inc. and Subsidiaries

## Financial Highlights

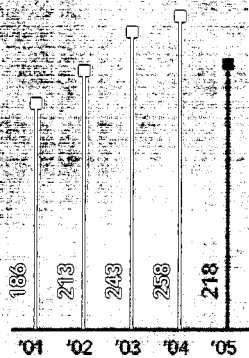
As of August 27, 2005

Years Ended (In thousands, except per share amounts and store data)	August 27, 2005	August 28, 2004
Net sales	\$ 5,824,808	\$ 5,281,888
Cost of sales	3,908,569	3,496,278
Gross margin	1,916,239	1,785,610
Selling, general and administrative expenses	1,573,444	1,378,948
Income before income taxes	342,795	406,662
Income taxes	125,286	148,758
Net income	\$ 217,509	\$ 257,904
Net income per common share – basic	\$ 1.30	\$ 1.51
Net income per common share – diluted	\$ 1.30	\$ 1.50
Dividends declared	\$ 61,538	\$ 56,077
Dividends declared per common share	\$ 0.37	\$ 0.33
Total assets	\$ 2,409,501	\$ 2,224,361
Working capital	\$ 460,157	\$ 489,727
Shareholders' equity	\$ 1,428,066	\$ 1,337,082
Comparable store sales gain	2.3%	1.9%
Stores opened	500	500
Stores closed	(68)	(61)
Number of stores – end of year	5,898	5,466

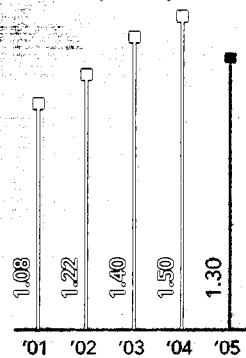
Net Sales  
(millions of dollars)



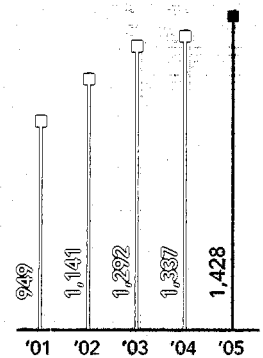
Net Income  
(millions of dollars)



Net Income Per Diluted Common Share  
(dollars)



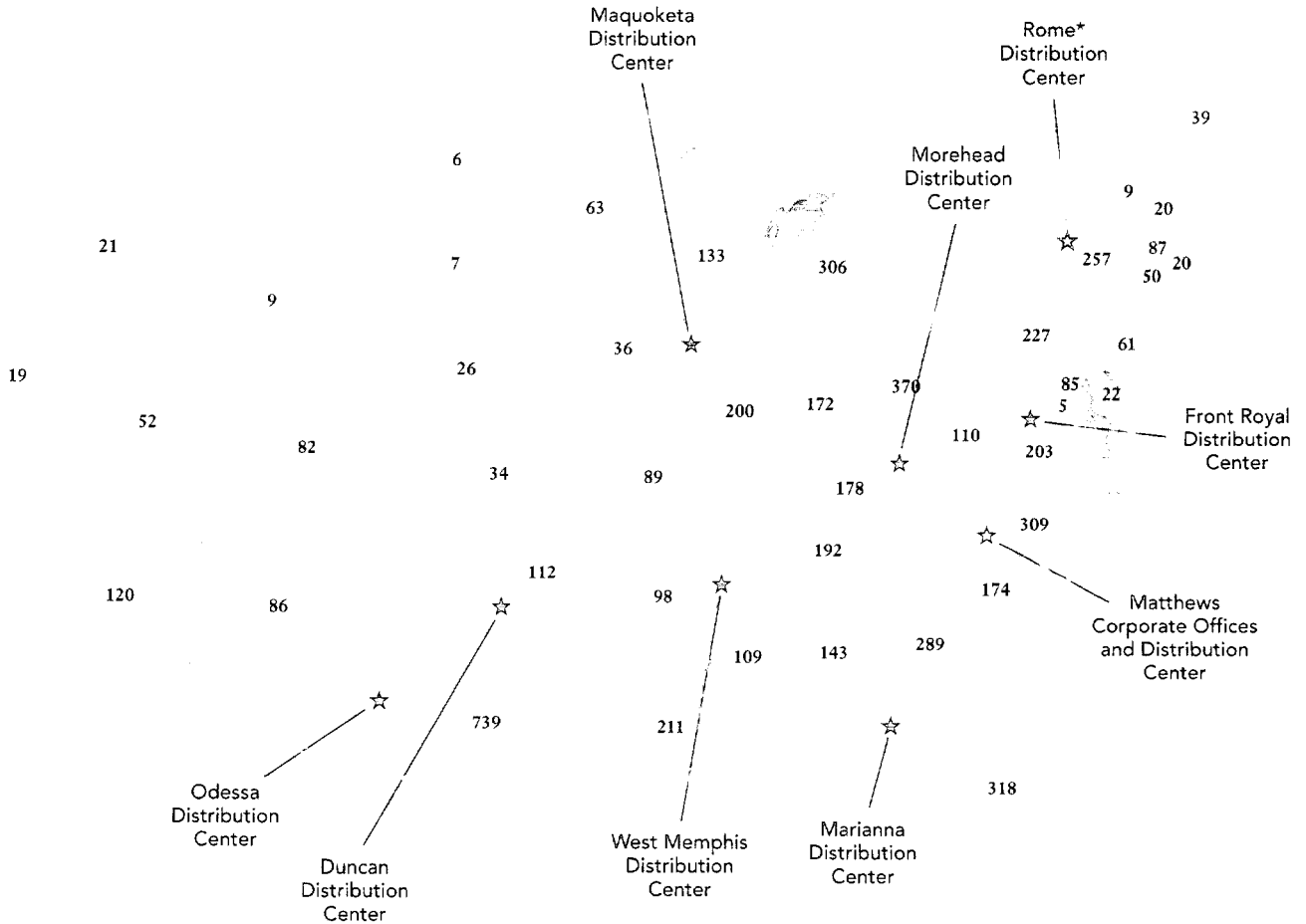
Shareholders' Equity  
(millions of dollars)





# Stores and Distribution Centers

As of August 27, 2005



## Distribution Service Areas\*

## Number of Stores

As of Fiscal Year End

Marianna, Florida  
907,000 Square Feet  
Opened 2005

Duncan, Oklahoma  
907,000 Square Feet  
Opened 1999

Odessa, Texas  
907,000 Square Feet  
Opened 2003

Front Royal, Virginia  
907,000 Square Feet  
Opened 1998

Maquoketa, Iowa  
850,000 Square Feet  
Opened 1994

West Memphis, Arkansas  
850,000 Square Feet  
Opened 1994

Morehead, Kentucky  
907,000 Square Feet  
Opened 2000

Matthews, North Carolina  
890,000 Square Feet  
Opened 1974

\* Opening in 2006: Rome, New York Distribution Center, 907,000 Square Feet

'96 '97 '98 '99 '00 '01 '02 '03 '04 '05

## Directors

**Mark R. Bernstein** <sup>2,3\*</sup>  
Retired Partner (Of Counsel),  
Parker, Poe, Adams and Bernstein  
L.L.P. Attorneys at Law;  
Lead Director

**Sharon Allred Decker** <sup>2,3</sup>  
Chief Executive Officer,  
The Tapestry Group, LLC

**Edward C. Dolby** <sup>1</sup>  
President, The Edward C. Dolby  
Strategic Consulting Group, LLC

**Glenn A. Eisenberg** <sup>1\*</sup>  
Executive Vice President,  
Finance and Administration,  
The Timken Company

**Howard R. Levine**  
Chairman of the Board and  
Chief Executive Officer,  
Family Dollar Stores, Inc.

**George R. Mahoney, Jr.**  
Retired, Former Executive Vice  
President, Family Dollar Stores, Inc.

**James G. Martin** <sup>1,2\*,3</sup>  
Corporate Vice President,  
Carolinas HealthCare System

1. Audit Committee  
2. Compensation Committee  
3. Nominating/Corporate Governance  
Committee

\* Committee Chairperson

## Officers

**Howard R. Levine**  
Chairman of the Board and  
Chief Executive Officer

**R. James Kelly**  
Vice Chairman,  
Chief Financial Officer and  
Chief Administrative Officer

**Robert A. George**  
Executive Vice President —  
Chief Merchandising Officer

**Charles S. Gibson, Jr.**  
Executive Vice President —  
Supply Chain

**Dorlisa K. Flur**  
Senior Vice President —  
Strategy and Business  
Development

**Keith M. Gehl**  
Senior Vice President —  
Construction and Facilities  
Management

**Joshua R. Jewett**  
Senior Vice President —  
Chief Information Officer

**Janet G. Kelley**  
Senior Vice President —  
General Counsel and Secretary

**John J. Scanlon**  
Senior Vice President —  
Hardlines and Marketing

**C. Martin Sowers**  
Senior Vice President — Finance

**Barry W. Sullivan**  
Senior Vice President —  
Store Operations

**Elizabeth M. Austin**  
Vice President — Information  
Technology Operations

**Samuel J. Bernstein**  
Vice President — Marketing

**Earl C. Bonnecaze**  
Vice President — Store Operations

**James R. Bowen**  
Vice President — Distribution

**James W. Burns**  
Vice President — Transportation

**Bryan P. Causey**  
Vice President — Planning and  
Merchandise Control

**Mark S. Chidester**  
Vice President — Human  
Resources, Store Operations

**Ramesh Chikkala**  
Vice President — Store Process  
Improvement

**Charles D. Curry**  
Vice President — Real Estate,  
Store Planning and Development

**Allen W. Fields**  
Vice President — Store Operations

**Eric C. Gordon**  
Vice President —  
Business Applications

**R. Dodd Haynes**  
Vice President — Internal Audit

**Dennis A. Heskett**  
Vice President — Store Operations

**Billy W. Jones, Jr.**  
Vice President — Distribution

**Timothy A. Matz**  
Vice President — General  
Merchandise Manager, Hardlines

**Dennis C. Merriam**  
Vice President —  
Human Resources, Distribution  
and Employee Relations

**Jacob J. Modla**  
Assistant General Counsel —  
Litigation

**John R. Moffitt**  
Vice President — Allocation  
and Replenishment

**Stephen F. Phillips**  
Vice President — Store Operations

**Richard P. Siliakus**  
Vice President — General  
Merchandise Manager, Hardlines

**Kenneth T. Smith**  
Vice President — Finance

**Jerome G. Vickers**  
Vice President — Store Operations

**Michael J. Zuege**  
Vice President — Loss Prevention

**Daylon W. Powell**  
Assistant Treasurer

**Janice B. Burris**  
Assistant Secretary

## Shareholder Information

## Annual Meeting

The Annual Meeting of Shareholders will be held at 2:00 p.m. at the Company's Corporate Headquarters at 10401 Monroe Road, Matthews, North Carolina, on Thursday, January 19, 2006.

## Independent Registered Public Accounting Firm

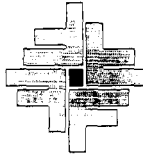
PricewaterhouseCoopers LLP  
Charlotte, North Carolina 28202

## Transfer Agent and Registrar

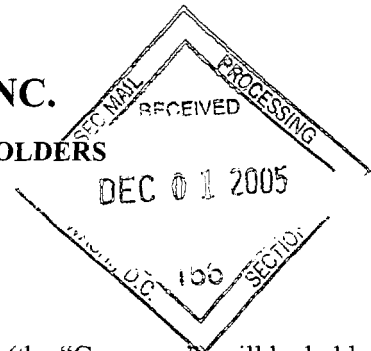
Mellon Investor Services LLC  
480 Washington Boulevard  
Jersey City, New Jersey 07310  
1-800-676-0868; 1-800-231-5469 (for hearing impaired);  
1-201-329-8660 (for foreign shareholders)  
www.melloninvestor.com

## Form 10-K and SEC and NYSE Certifications

A copy of the Form 10-K filed by the Company with the Securities and Exchange Commission (the "SEC") for fiscal 2005, 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, may be obtained by shareholders without charge upon written request to Janice B. Burris, Assistant Secretary, at the Corporate Headquarters. The Form 10-K is also available on Family Dollar's website at [www.familydollar.com](http://www.familydollar.com). The Company has filed with 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.



**FAMILY DOLLAR STORES, INC.**  
**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS**  
**TO BE HELD JANUARY 19, 2006**



**TO THE SHAREHOLDERS:**

The Annual Meeting of Shareholders of Family Dollar Stores, Inc. (the "Company") will be held at 2:00 p.m. on Thursday, January 19, 2006, at the office of the Company at 10401 Monroe Road, Matthews, North Carolina 28201-1017, for the following purposes:

- (1) To elect a Board of seven directors;
- (2) To consider and vote upon a proposal to adopt the Family Dollar Stores, Inc. 2006 Incentive Plan;
- (3) To ratify the action of the Audit Committee of the Board of Directors in appointing PricewaterhouseCoopers LLP as independent registered public accountants to audit the consolidated financial statements of the Company and its subsidiaries for the current fiscal year; and
- (4) To transact such other business as may properly come before the Annual Meeting or any adjournments thereof.

The Board of Directors has fixed the close of business on November 22, 2005, as the record date for the determination of Shareholders entitled to notice of and to vote at the Annual Meeting or any adjournments thereof. The voting list of Shareholders will be available for inspection in accordance with the Company's Bylaws at the Company's office at 10401 Monroe Road, Matthews, North Carolina, at least ten days prior to the Annual Meeting.

Each Shareholder who does not plan to attend the Annual Meeting is requested to sign, date and return the accompanying proxy card in the enclosed postage-paid return envelope. Alternatively, Shareholders may vote by touch-tone telephone by calling the toll-free number printed on the proxy card and following the recorded instructions. In addition, Shareholders may vote through the internet by visiting [www.proxyvote.com](http://www.proxyvote.com) and following the online instructions. Shareholders will need the control number that appears on the enclosed proxy card when voting by telephone or through the internet.

By Order of the Board of Directors

JANET G. KELLEY  
Senior Vice President  
General Counsel and Secretary

Matthews, North Carolina  
November 30, 2005

# **FAMILY DOLLAR STORES, INC.**

Post Office Box 1017  
Charlotte, North Carolina 28201-1017

---

## **PROXY STATEMENT**

---

This Proxy Statement is furnished to the holders of the Common Stock (the "Common Stock") of Family Dollar Stores, Inc. (the "Company") in connection with the solicitation, on behalf of the Board of Directors of the Company, of proxies to be voted at the Annual Meeting of Shareholders to be held on January 19, 2006, or any adjournments thereof (the "Annual Meeting"). This Proxy Statement and the enclosed proxy were first sent to Shareholders on or about November 30, 2005.

The enclosed proxy is for use at the Annual Meeting if the Shareholder will not attend in person. Any Shareholder giving a proxy may revoke it at any time before it is exercised by delivering written notice of such revocation to the Secretary of the Company or by attending the Annual Meeting and voting. All shares represented by valid proxies received pursuant to this solicitation and not revoked before they are exercised will be voted in the manner specified therein. Unless you indicate otherwise on your proxy card, the proxies will be voted FOR:

1. The election to the Board of Directors of the seven nominees named in the Proxy Statement (Proposal No. 1);
2. The proposal to approve the Family Dollar Stores, Inc. 2006 Incentive Plan (the "2006 Plan") (Proposal No. 2); and
3. The ratification of the action of the Audit Committee of the Board of Directors in appointing PricewaterhouseCoopers LLP as independent registered public accountants to audit the consolidated financial statements of the Company and its subsidiaries for the current fiscal year (Proposal No. 3).

The presence, in person or by proxy, of the holders of a majority of the shares entitled to vote is necessary for a quorum at the Annual Meeting. Directors are elected by a plurality of the votes of shares present in person or represented by proxy at the Annual Meeting. The approval of the 2006 Plan requires the affirmative vote of a majority of shares entitled to vote on the proposal and present or represented by proxy at the Annual Meeting. In addition, to satisfy requirements of the New York Stock Exchange ("NYSE"), the 2006 Plan must be approved by a majority of the votes cast, and the total votes cast must represent over fifty percent (50%) of all outstanding Common Stock. The ratification of the appointment of PricewaterhouseCoopers LLP requires the affirmative vote of a majority of shares entitled to vote on the proposal and present or represented by proxy at the Annual Meeting.

Abstentions will be counted for the purpose of determining the existence of a quorum and will have the same effect as a negative vote on matters other than the election of directors. Abstentions are not relevant to the election of directors. If a nominee holding shares for a beneficial owner indicates on the proxy that it does not have discretionary authority as to certain shares to vote on a particular matter or otherwise does not vote such shares (a "broker non-vote"), those shares will not be considered present and entitled to vote with respect to that matter, but will be counted for the purpose of determining the existence of a quorum. For the purpose of the NYSE requirement that the total votes cast on the proposal to approve the 2006 Plan be over fifty percent (50%) of all outstanding shares, abstentions will count as a negative vote cast but broker non-votes will not.

The cost of soliciting proxies for the Annual Meeting will be borne by the Company. Directors, officers and employees of the Company may solicit proxies personally or by mail, telephone or facsimile. In addition, arrangements may be made with brokerage firms, banks and other custodians, nominees and fiduciaries to send proxy material to their principals. The Company will reimburse these institutions for their reasonable costs in doing so. Though the Company has no such plans at this time, the Company may subsequently decide to retain a professional proxy solicitation service, the cost of which would be borne by the Company.

Only the record holders of Common Stock at the close of business on November 22, 2005, will be entitled to vote at the Annual Meeting. On such date, 155,265,413 shares of Common Stock were outstanding and Shareholders will be entitled to one vote for each share held.

## **PROPOSAL NO. 1**

### **ELECTION OF DIRECTORS**

At the Annual Meeting, seven directors are to be elected to serve until the next annual meeting of Shareholders or until their respective successors are elected and qualified. The number of directors is established by the Board of Directors pursuant to the Company's Bylaws. Votes cast pursuant to the enclosed proxy will be cast for the election of the seven nominees named below unless authority is withheld. All seven nominees are now members of the Board of Directors. If for any reason any nominee shall not be a candidate for election as a director at the Annual Meeting (an event that is not now anticipated), the enclosed proxy will be voted for such substitute as shall be designated by the Board of Directors.

The Board of Directors met four times and acted by unanimous written consent in lieu of meeting on one occasion during the fiscal year ended August 27, 2005 ("fiscal 2005"). Each director attended all of the meetings of the Board and the Committees on which he or she served. Pursuant to Corporate Governance Guidelines adopted by the Board, Board members are expected to attend Board meetings on a regular basis and to attend the Annual Meeting of Shareholders. All of the nominees for election (who constituted the entire Board) attended the Company's last annual meeting.

The following information is furnished with respect to the seven nominees. The Board of Directors has determined that each of the nominees, other than Messrs. Levine and Mahoney, are independent directors within the meaning of the NYSE listing standards.

*Mark R. Bernstein*, age 75, has served as a director since 1980. He is Of Counsel with the law firm of Parker, Poe, Adams & Bernstein L.L.P. Prior to his January 2002 retirement, he was a partner in the law firm for more than the preceding five years. Mr. Bernstein was elected as the Lead Director of the Board of Directors in August 2004. He is the Chairman of the Nominating/Corporate Governance Committee and a member of the Compensation Committee.

*Sharon Allred Decker*, age 48, has served as a director since 1999. Mrs. Decker has been the CEO of The Tapestry Group, LLC, a consulting, communications and marketing firm since September 2004. From April 2003 to August 2004, she was President of The Tanner Companies, a manufacturer and retailer of apparel. From August 1999 to March 2003, she was President of Doncaster, a division of The Tanner Companies. Doncaster is a direct sales organization selling a high-end line of women's apparel. From January 1997 to July 1999, she was President and Chief Executive Officer of The Lynnwood Foundation, which created and now manages a conference facility and leadership institute. Mrs. Decker also is a director of Coca-Cola Bottling Co. Consolidated. Mrs. Decker serves on the Compensation and the Nominating/Corporate Governance Committees.

*Edward C. Dolby*, age 60, has served as a director since 2003. He has been the President of The Edward C. Dolby Strategic Consulting Group, LLC since September 2002, when he established the company to engage in business consulting. Prior to his retirement in December 2001, Mr. Dolby was employed by Bank of America Corporation for 32 years, where his positions included President of the North Carolina and South Carolina Consumer and Commercial Bank. Mr. Dolby is a member of the Audit Committee.

*Glenn A. Eisenberg*, age 44, has served as a director since 2002. He is the Executive Vice President - Finance and Administration of The Timken Company, a position he has held since January 2002. The Timken Company is an international manufacturer of highly engineered bearings and alloy steels and a provider of related products and services. From 1990 to 2001, Mr. Eisenberg was employed by United Dominion Industries, an international manufacturer of proprietary engineered products, where he held various positions, including President and Chief Operating Officer from December 1999 to May 2001. He is also a director of Alpha Natural Resources, Inc. Mr. Eisenberg is the Chairman of the Audit Committee and the Board of Directors has determined that he is an "audit committee financial expert," as defined by the applicable rules of the Securities and Exchange Commission (the "SEC").

*Howard R. Levine*, age 46, has served as a director since 1997. He was employed by the Company in various capacities in the Merchandising Department from 1981-1987, including employment as Senior Vice President – Merchandising and Advertising. From 1988 to 1992, Mr. Levine was President of Best Price Clothing Stores, Inc., a chain of ladies' apparel stores. From 1992 to April 1996, he was self-employed as an investment manager. He rejoined the Company in April 1996, and was elected Vice President-General Merchandise Manager: Softlines in April 1996, Senior Vice President-Merchandising and Advertising in September 1996, President and Chief Operating Officer in April 1997, Chief Executive Officer in August 1998, and Chairman of the Board in January 2003. Mr. Levine is the son of Leon Levine, the former Chairman of the Board and founder of the Company, who retired in January 2003.

*George R. Mahoney, Jr.*, age 63, has served as a director since 1987. He was employed by the Company as General Counsel in 1976 and served as the Executive Vice President, General Counsel and Secretary of the Company from 1991 until his retirement in May 2005.

*James G. Martin*, age 69, has served as a director since 1996. He has been associated with the Carolinas HealthCare System since January 1993, where he currently serves as a Corporate Vice President. He served as Governor of the State of North Carolina from 1985 to 1992 and was a member of the United States House of Representatives, representing the Ninth District of North Carolina, from 1973 until 1984. Dr. Martin is also a director of Duke Energy Corporation and Palomar Medical Technologies, Inc. Dr. Martin also serves as Chairman of the Board of aaiPharma, Inc., which is currently reorganizing pursuant to Chapter 11 of the federal bankruptcy code. Dr. Martin serves on the Audit, Compensation and Nominating/Corporate Governance Committees and is the Chairman of the Compensation Committee.

### **Compensation of Directors**

Directors who are not employees of the Company are paid \$3,500 for each Board meeting attended and \$750 for each Audit, Compensation and Nominating/Corporate Governance Committee meeting attended. The Chairman of the Audit Committee receives an additional \$500 per meeting and the Chairman of each of the Compensation and Nominating/Corporate Governance Committees receive an additional \$250 per meeting. Effective as of July 1, 2005, the Lead Director of the Board receives an additional annual cash retainer of \$12,000. Pursuant to the Family Dollar 2000 Outside Directors Plan (the "Directors Stock Plan"), non-employee directors also receive an annual grant of shares of the Company's Common Stock with a fair market value at the time of

the grant of \$20,000. The Board of Directors believes that the payment of a portion of the directors' fees in the form of an annual grant of shares of the Company's Common Stock supports the alignment of the directors' interests with the interests of the Company's Shareholders. Each of the current independent directors received a grant of 617 shares of Common Stock upon their re-election as directors in January 2005. In accordance with the Directors Stock Plan, Mr. Mahoney received a pro-rata grant of Common Stock equal to 510 shares upon his retirement in May 2005. Non-employee directors are required to maintain a level of equity interest in the Company equal to at least one-half of the cumulative number of shares of Common Stock of the Company awarded under the Directors Stock Plan since August 2004. The Company encourages, but does not require, that directors maintain an equity interest in the Company in excess of such minimum amounts. Finally, non-employee directors are reimbursed for reasonable expenses incurred by them in connection with attendance at Board and related functions. Directors who are employees of the Company receive no compensation for their Board service.

### **Recommendation of the Board of Directors**

The Board of Directors recommends that the Shareholders vote FOR the election of each of the nominees.

### **CORPORATE GOVERNANCE MATTERS AND COMMITTEES OF THE BOARD OF DIRECTORS**

Pursuant to the Company's Bylaws, the Board of Directors has established three standing committees: the Audit, Compensation and Nominating/Corporate Governance Committees. The Board of Directors has adopted Corporate Governance Guidelines that require a majority of the Board members and all members of each of the Company's Audit, Compensation and Nominating/Corporate Governance Committees to be independent, as defined by the NYSE listing standards. The Board has determined, after a review of the relationships between and among each of the directors, the Company and its officers, that all members of the Board, other than Messrs. Levine and Mahoney, and all members of the Board's current standing Committees are independent. Mark R. Bernstein, the Lead Director of the Company, was a partner in the law firm of Parker, Poe, Adams & Bernstein L.L.P. until his retirement in January 2002, and currently is Of Counsel to the law firm. Prior to fiscal 2005, the Company had paid legal fees to the law firm for legal services. The Board of Directors has considered the relationship of Mr. Bernstein and the law firm to the Company. Based on the fact that the law firm did not provide legal advice to the Company in fiscal 2005, and is not expected to provide such advice to the Company in the future; the nominal amounts paid by the Company to the law firm in prior fiscal years; the small percentage of these payments relative to the total revenues of the law firm; and the retirement of Mr. Bernstein from the law firm, the Board of Directors has determined that Mr. Bernstein qualifies as an independent director.

The Charters of the Audit, Compensation, and Nominating/Corporate Governance Committees, the Company's Corporate Governance Guidelines, and the Company's Codes of Conduct applicable to its officers, directors and employees are available on the Company's website at [www.familydollar.com](http://www.familydollar.com) under the tab "Investors-Corporate Governance" and are available in print to Shareholders upon request to the Company.

The principal functions of each of the Company's Board Committees, their members and the number of meetings held in fiscal 2005 are set forth below:

<u>Committee Name and Members</u>	<u>Committee Functions</u>	<u>Number of Meetings In Fiscal 2005</u>
<b>Audit</b> Eisenberg* Dolby Martin	<ul style="list-style-type: none"> <li>• Assist the Board of Directors in fulfilling its responsibilities with respect to oversight of:               <ul style="list-style-type: none"> <li>(i) the integrity of the Company's financial statements;</li> <li>(ii) the Company's compliance with legal and regulatory requirements;</li> <li>(iii) the independent auditor's qualifications and independence; and</li> <li>(iv) the performance of the Company's internal audit function and independent auditors.</li> </ul> </li> <li>• Perform such other functions and duties as are set forth in the Charter</li> </ul>	9
<b>Compensation</b> Martin* Bernstein Decker	<ul style="list-style-type: none"> <li>• Evaluate and recommend compensation for selected senior executive officers of the Company</li> <li>• Establish the compensation of the Chairman of the Board and the CEO</li> <li>• Oversee the Company's equity compensation plans</li> <li>• Evaluate and review the Company's overall compensation and benefit structure, including the review and approval of pre-tax earnings goals and payment of bonuses under the Company's Incentive Profit Sharing Plan</li> <li>• Perform such other functions and duties as are set forth in the Charter</li> </ul>	6
<b>Nominating/ Corporate Governance</b> Bernstein* Decker Martin	<ul style="list-style-type: none"> <li>• Identify and recommend to the Board individuals to fill vacant Board positions and/or nominees for election as directors at the Annual Meeting of Shareholders</li> <li>• Review the structure, independence and composition of the Board and its Committees and the Committee charters and make recommendations to the Board</li> <li>• Evaluate the performance of the Board and Committees and report findings to the Board</li> <li>• Review and recommend to the Board plans for the succession of the Company's CEO and other senior executive officers, as necessary</li> <li>• Develop (with Company management) director orientation programs</li> <li>• Nominate for Board approval the Chairman and the Lead Director, if applicable, and make recommendations to the Board regarding their respective roles</li> <li>• Review and make recommendations as provided in the Company's Codes of Business Conduct</li> <li>• Evaluate and make recommendations to the Board regarding shareholder proposals</li> <li>• Recommend to the Board and oversee the implementation of sound corporate governance principles and practices</li> <li>• Perform such other functions and duties as are set forth in the Charter</li> </ul>	3

\*Chairman of the Committee

### **Nominees for Election as Directors**

The Nominating/Corporate Governance Committee considers nominees proposed by Shareholders of the Company. As provided in the Company's Corporate Governance Guidelines, the Nominating/Corporate Governance Committee will seek Board candidates who possess and have exhibited integrity in business and



personal affairs and whose professional experiences will assist the Board in performing its duties. The Nominating/Corporate Governance Committee has not established any specific, minimum qualifications for potential nominees. The Nominating/Corporate Governance Committee's process for evaluating nominees for director will not differ based on whether the nominee is recommended by a Shareholder. To recommend a prospective nominee for the Committee's consideration, Shareholders should submit the candidate's name and qualifications, in writing, to the Company's Secretary at the following address: Family Dollar Stores, Inc., Attention: Secretary, P.O. Box 1017, Charlotte, NC 28201-1017. Any such submission must be accompanied by the written consent of the proposed nominee to serve as a director if elected. The Nominating/Corporate Governance Committee will extend invitations on behalf of the Company to join the Board of Directors or to be nominated for election as a director.

### **Communication with the Board of Directors**

Shareholders may communicate with the Board of Directors, the Lead Director or the independent directors as a group by sending correspondence addressed to the applicable party to: Board of Directors, Family Dollar Stores, Inc., P.O. Box 1017, Charlotte, NC 28201-1017, or by sending an email addressed to Board@familydollar.com. Pursuant to procedures approved by the independent members of the Board of Directors, all such correspondence related to the Board's duties and responsibilities will be reviewed by the Company's General Counsel and forwarded to the Lead Director or summarized in periodic reports to the Lead Director. All such correspondence will be available to any of the directors upon request.

### **Report of the Audit Committee of the Board of Directors**

During fiscal 2005, Glenn A. Eisenberg served as Chairman of the Audit Committee of the Board of Directors. Members of the Audit Committee during fiscal 2005 included James G. Martin and Edward C. Dolby. The Board of Directors has determined that all members of the Audit Committee are independent and are financially literate as required by the NYSE listing standards, and that Mr. Eisenberg is an "audit committee financial expert," as defined by the SEC guidelines, and has accounting or related financial management expertise, as required by the NYSE's listing requirements.

The Audit Committee has reviewed and discussed the audited financial statements of the Company for fiscal 2005 with the Company's management. The Audit Committee has discussed with PricewaterhouseCoopers LLP ("PwC"), the Company's independent registered public accountants, the matters required to be discussed by Statement on Auditing Standards No. 61 (Communications with Audit Committees), as amended by Statement on Auditing Standards No. 90 (Audit Committee Communications).

The Audit Committee has also received the written disclosures and the letter from PwC required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees), and has discussed the independence of PwC with that firm.

Based on the Audit Committee's review and the discussions noted above, the Audit Committee recommended to the Board of Directors that the Company's audited financial statements be included in the Company's Annual Report on Form 10-K for fiscal 2005 for filing with the SEC.

This report is submitted by Glenn A. Eisenberg, Chairman, Edward C. Dolby and James G. Martin.

## EXECUTIVE COMPENSATION

### Summary Compensation Table

The following table sets forth information concerning the compensation during fiscal years 2005, 2004 and 2003 for the Company's Chief Executive Officer, the four other most highly compensated executive officers who served in such capacities as of the end of fiscal 2005, and two other officers who would have been among the Company's most highly compensated executive officers but for the fact that such officers were no longer employed by the Company at the end of fiscal 2005 (collectively, the "Named Executive Officers").

<i>Name and Principal Position</i>	<i>Annual Compensation</i>				<i>Securities Underlying Options(4)</i>	<i>All Other Compen- sation (\$)(5)</i>
	<i>Fiscal Year</i>	<i>Salary (\$)(1)</i>	<i>Bonus (\$)(1)(2)</i>	<i>Other Annual Compensation(\$)(3)</i>		
Howard R. Levine Chairman of the Board and Chief Executive Executive Officer (6)	2005	728,409	0	45,370	200,000	26,150
	2004	726,794	445,525	55,350	200,000	23,810
	2003	700,000	483,000	–	175,000	20,215
R. James Kelly Vice Chairman, Chief Financial and Administrative Officer	2005	462,977	0	–	110,000	20,850
	2004	462,323	170,042	–	110,000	19,427
	2003	450,000	207,000	–	100,000	14,714
Charles S. Gibson, Jr. Executive Vice President – Supply Chain (7)	2005	277,640	0	–	60,000	15,931
	2004	266,602	83,713	–	60,000	15,399
	2003	247,694	78,024	–	50,000	6,428
Janet G. Kelley Senior Vice President – General Counsel and Secretary (8)	2005	262,390	0	–	45,000	16,813
	2004	184,728	64,655	–	40,000	65,745
Irving Neger Former Senior Vice President –Softlines (9)	2005	263,025	0	–	30,000	15,834
	2004	256,986	55,252	–	40,000	15,339
	2003	244,231	71,560	–	45,000	5,901
R. David Alexander, Jr. Former President and Chief Operating Officer (10)	2005	403,409	0	–	110,000	18,748
	2004	402,179	147,921	–	110,000	18,754
	2003	368,539	169,528	–	100,000	15,160
George R. Mahoney, Jr. Former Executive Vice President – General Counsel and Secretary (11)	2005	307,050	0	–	60,000	17,421
	2004	336,718	105,729	–	95,000	16,776
	2003	323,076	118,595	–	85,000	14,651

(1) Includes amounts deferred by certain of the Named Executive Officers pursuant to the Family Dollar Compensation Deferral Plan (the "Deferred Compensation Plan").

- (2) Amounts earned under the Company's Incentive Profit Sharing Plan for the stated fiscal year but paid after the close of that fiscal year.
- (3) Reflects the incremental cost to the Company of Mr. Levine's personal use of Company aircraft. No other Named Executive Officer received perquisites or other personal benefits, other than those benefits generally available to all Company employees, or as set forth under the column "All Other Compensation."
- (4) Stock options were granted pursuant to the Family Dollar Stores, Inc. 1989 Non-Qualified Stock Option Plan (the "1989 Plan").
- (5) Includes the Company's payment of annual premiums for each of the Named Executive Officers for fiscal 2005 in the amount of: (i) \$781 for the provision of short term disability insurance coverage and (ii) \$5,952 for the Medical Expense Reimbursement Plan. Also includes premiums paid in fiscal 2005 for personal umbrella liability insurance coverage for Howard R. Levine in the amount of \$6,338, for Charles S. Gibson, Jr., in the amount of \$453, for R. David Alexander, Jr., in the amount of \$778 and for George R. Mahoney, Jr., in the amount of \$678. Also includes \$52,856 in customary relocation expenses for which Ms. Kelley was reimbursed in fiscal 2004. Also includes Company contributions to the 401(k) plan, premiums for term life insurance (including accidental death and dismemberment coverage) and premiums paid for executive disability insurance coverage (program began in fiscal 2004), all in the amounts as set forth in the following table for fiscal 2005.

<u>Name</u>	<u>401(k)</u>	<u>Term Life Insurance</u>	<u>Executive Disability</u>	<u>Long Term Disability</u>
Howard R. Levine	\$3,150	\$2,520	\$4,589	\$2,820
R. James Kelly	3,150	2,333	5,814	2,820
Charles S. Gibson, Jr.	3,175	1,399	1,561	2,610
Janet G. Kelley	4,399	1,322	1,893	2,466
Irving Neger	3,126	1,326	2,177	2,472
R. David Alexander, Jr.	3,492	2,033	2,892	2,820
George R. Mahoney, Jr.	2,209	1,514	3,467	2,820

- (6) Mr. Levine was elected Chairman of the Board in January 2003.
- (7) Mr. Gibson was elected Executive Vice President – Supply Chain in September 2003.
- (8) Ms. Kelley joined the Company during the 2004 fiscal year as Senior Vice President and Senior Counsel and was promoted in May 2005 to Senior Vice President, General Counsel and Secretary.
- (9) Mr. Neger's employment with the Company terminated on October 20, 2005.
- (10) Mr. Alexander served as President and Chief Operating Officer from January 2003 until his resignation from the Company on August 4, 2005. A portion of Mr. Alexander's fiscal 2005 salary includes regular salary payments made after Mr. Alexander's resignation pursuant to Mr. Alexander's Employment Agreement with the Company. See "Employment Agreements and Other Contracts," below.
- (11) Mr. Mahoney retired from the Company in May 2005.

### **Option Grants During the Fiscal Year Ended August 27, 2005**

The following table sets forth all options to acquire shares of the Company's Common Stock granted during fiscal 2005 to the Named Executive Officers. The potential realizable value amounts shown in the table are the values that might be realized upon exercise of options immediately prior to the expiration of their term based on arbitrarily assumed annualized rates of appreciation in the price of the Company's Common Stock of five percent and ten percent over the term of the options, as set forth in the rules of the SEC. Actual gains, if any, on stock option exercises are dependent on the future performance of the Common Stock. There can be no assurance that the potential realizable values shown in the table will be achieved.

*Individual Grants(1)*

<i>Name</i>	<i>Number of Securities Underlying Options Granted</i>	<i>Percent of Total Options Granted to Employees in Fiscal Year</i>	<i>Exercise or Base Prices (\$/Sh)</i>	<i>Expiration Date</i>	<i>Potential Realizable Value At Assumed Annual Rates of Stock Price</i>	
					<i>5%(\$)</i>	<i>10%(\$)</i>
Howard R. Levine	200,000	9.5	27.00	10/04/09	1,491,920	3,296,754
R. James Kelly	110,000	5.2	27.00	10/04/09	820,556	1,813,215
Charles S. Gibson, Jr.	60,000	2.8	27.00	10/04/09	447,576	989,026
Janet G. Kelley	20,000	0.9	27.00	10/04/09	149,192	329,675
	25,000	1.2	32.25	03/06/10	222,752	492,224
Irving Neger (2)	30,000	1.4	27.00	10/04/09	0	0
R. David Alexander, Jr. (3)	110,000	5.2	27.00	10/04/09	0	0
George R. Mahoney, Jr. (4)	60,000	2.8	27.00	10/04/09	447,576	989,026

- (1) Stock options were granted pursuant to the 1989 Plan. The exercise price for each option is the fair market value per share of Common Stock on the date of the grant. Options vest in increments of 40% on the second anniversary of the grant date and an additional 30% on each of the third and fourth grant date anniversaries. See "Report of the Compensation Committee of the Board of Directors on Executive Compensation" for a description of other material terms of the 1989 Plan.
- (2) Pursuant to the 1989 Plan, the unvested options granted to Mr. Neger in fiscal 2005 have been cancelled as a result of the termination of his employment with the Company.
- (3) Pursuant to the 1989 Plan, the unvested options granted to Mr. Alexander in fiscal 2005 have been cancelled as a result of his resignation from the Company.
- (4) Pursuant to the 1989 Plan, as amended with the approval of Shareholders in January 2005, certain options granted to qualifying retirees, including those granted to Mr. Mahoney, continue to vest in accordance with their original vesting schedule, as described in footnote (1) above.

**Option Exercises and Fiscal Year-End Values**

The following table sets forth all options exercised during fiscal 2005 by the Named Executive Officers, and the number and value of unexercised options held by such executive officers at fiscal year-end.

<i>Name</i>	<i>Shares Acquired on Exercise(#)</i>	<i>Value Realized (\$)(1)</i>	<i>Number of Securities Underlying Unexercised Options at FY-End(#)</i>		<i>Value of Unexercised In-the-Money Options at FY-End(\$)(2)</i>	
			<i>Exercisable</i>	<i>Unexercisable</i>	<i>Exercisable</i>	<i>Unexercisable</i>
Howard R. Levine	225,000	1,546,250	375,000	350,000	0	0
R. James Kelly	75,000	349,500	209,500	195,500	0	0
Charles S. Gibson, Jr.	25,000	392,750	104,500	100,500	0	0
Irving Neger	50,000	343,000	75,500	64,500	0	0
Janet G. Kelley	0	0	0	85,000	0	0
R. David Alexander, Jr.	75,000	252,000	74,000	25,500	0	0
George R. Mahoney, Jr.	110,000	634,200	178,000	132,000	0	0

- (1) The value realized is calculated based on the difference between the option exercise price and the closing market price of the Company's Common Stock on the date prior to the date of the exercise multiplied by the number of shares exercised.
- (2) The value of unexercised options is calculated based on the difference between the option exercise price and the closing price of the Company's Common Stock, as reported on the NYSE Composite tape on August 26, 2005, of \$20.24.

## Equity Compensation Plan Information

The following table provides information with respect to the shares of the Company's Common Stock that may be issued under the 1989 Plan and the Directors Stock Plan, which are the only equity compensation plans that the Company currently maintains, as of August 27, 2005.

<u>Plan Category</u>	<u>(a) Number of Securities to be Issued Upon Exercise Of Outstanding Options Warrants and Rights (1)</u>	<u>(b) Weighted Average Exercise Price of Outstanding Options</u>	<u>(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (2)</u>
Equity Compensation Plans Approved by Shareholders	6,061,592	\$30.44/share	4,287,297

(1) Consists of shares issuable upon exercise of options granted under the 1989 Plan.

(2) Consists of 4,216,338 shares available for awards of options under the 1989 Plan and 70,959 shares available to be granted under the Directors Stock Plan.

## Employment Agreements and Other Contracts

The Company has entered into Employment Agreements with the Chairman of the Board and CEO Howard R. Levine; Vice Chairman, Chief Financial and Administrative Officer R. James Kelly; and Executive Vice President Charles S. Gibson, Jr. The Employment Agreements each provide for a one-year rolling term, which automatically extends each month for an additional month; provided, that either party may terminate the extensions by written notice to the other party. The Employment Agreements provide for a weekly base salary, subject to annual review by the Board, and for participation in the Company's Incentive Profit Sharing Plan. Subject to certain terms and conditions contained therein, the Employment Agreements provide that the Company will pay severance of one year's base salary if the Company terminates the Agreement prior to its expiration; provided that such termination is not for Cause or a result of Medical Disability (as defined in the Employment Agreements). The Employment Agreements also provide for payments of pro-rata bonus amounts under the Company's Incentive Profit Sharing Plan upon a termination that is not for Cause. The Employment Agreements prohibit the officers from engaging in activities that compete with the Company (with the definition of competitive companies for such purpose being narrower in scope in Mr. Gibson's agreement) and from soliciting employees of the Company for one year after the termination of their respective agreements, regardless of the reason for termination.

On August 2, 2005, R. David Alexander, Jr. resigned as President and Chief Operating Officer of the Company effective August 4, 2005. In connection with such resignation, the Company and Mr. Alexander entered into a written letter agreement dated August 2, 2005 (the "Letter Agreement") which reaffirmed key provisions of Mr. Alexander's Employment Agreement with the Company, dated August 25, 2000 (as amended from time-to-time), including a one year covenant not to compete with the Company for or on behalf of any Competitive Company (as such term is defined in the Employment Agreement). The Letter Agreement also provided for the payment of Mr. Alexander's regular salary for the 26 week period directly following his resignation, provided, that if Mr. Alexander accepts or begins other employment in any capacity prior to February 3, 2006, any unpaid balance of such severance as of the date of such new employment shall be eliminated or reduced by the monthly remuneration and compensation from his new employment. Mr. Alexander received no additional termination or severance benefits other than those set forth in the Letter Agreement, the Employment Agreement and those benefits generally available to all Company employees under various Company plans.

Pursuant to a Letter Agreement dated July 31, 2000, between the Company and Irving Neger, Mr. Neger is entitled to receive three months base salary as a result of his termination from the Company. This severance arrangement was reaffirmed in a Separation Benefit Agreement and Release of Claims dated November 1, 2005, between the Company and Mr. Neger. Mr. Neger will also receive a pro-rata award of performance shares pursuant to the 2006 Plan, provided that the Plan is approved by the Shareholders. Aside from these performance shares, the severance payments described above, and the benefits generally available to all Company employees under various Company plans, Mr. Neger will not receive any additional termination or severance benefits.

Presently, no other executive officer of the Company is party to an employment agreement with the Company, except that the Company has entered into an employment agreement with Robert A. George, Executive Vice President – Merchandising, on substantially the same terms and conditions as the Employment Agreement with Charles S. Gibson, Jr.

### **REPORT OF THE COMPENSATION COMMITTEE OF THE BOARD OF DIRECTORS ON EXECUTIVE COMPENSATION**

The Compensation Committee of the Board of Directors administers the Company's compensation programs for its executive officers. During fiscal 2005, the Compensation Committee was composed of Mark R. Bernstein, Sharon Allred Decker and James G. Martin, none of whom are eligible to receive options under the 1989 Plan. The objectives of the Company's executive compensation program are to provide a competitive total compensation package that enables the Company to attract and retain key executives and to offer compensation opportunities that are directly related to the annual and long-term performance of the Company. The Company seeks to link a significant portion of compensation to the Company's performance so that executive officers will have a strong incentive to meet the Company's goals and so their compensation will be aligned with the interests of the Company's Shareholders. With these objectives, the compensation of executive officers has historically consisted primarily of (i) a base salary; (ii) annual incentive compensation in the form of a bonus based on the achievement of a pre-tax earnings goal and the executive's contributions to meeting that goal; and (iii) long-term incentive compensation in the form of stock options. The Committee has retained and received the advice of a compensation consultant, Hay Group, Inc., with respect to the establishment of the compensation of certain of the Company's senior executive officers and the implementation of new compensation programs, as discussed below under "Proposal No. 2 – Approval of 2006 Incentive Plan." Tally sheets setting forth all compensation components for each Named Executive Officer were prepared for, and reviewed by the Committee in connection with the Committee's consideration of fiscal 2006 executive compensation packages. The Compensation Committee believes that the total compensation packages offered to its executive officers are reasonable and competitive.

Executive officers participate with other employees in the Company's 401(k) Plan and in the Deferred Compensation Plan, which is available to certain members of Company management. Under the Deferred Compensation Plan, eligible employees may defer receipt of a portion of their base salary and/or bonus earned under the Incentive Profit Sharing Plan. Amounts deferred under the Plan may be invested in a limited number of actual market-based investment choices selected by the participants, although the participants do not have an interest in any actual trust assets or other Company property set aside in their name. The Company does not contribute to, guarantee or supplement any returns under the Deferred Compensation Plan. As of the end of fiscal 2005, 49 employees, including six executive officers, were participants in the Deferred Compensation Plan, and the aggregate amount credited under the Plan was \$4,211,691.

Base Salary. The Compensation Committee reviews and approves the compensation of all officers at the level of Executive Vice President and above, and of all Named Executive Officers. In addition, the Compensation Committee annually reviews the compensation of all officers at the level of Senior Vice President and above. In

determining the salary level of each executive, the Compensation Committee takes into consideration the responsibilities, experience and performance of the executives, their contributions to the Company's operating performance (including the achievement of pre-tax earnings goals), and competitive salary practices of other companies, including comparable companies in the retail industry.

Incentive Profit Sharing Plan. The Compensation Committee also reviews and approves a pre-tax earnings goal established by the Company each fiscal year under the Company's Incentive Profit Sharing Plan. This Plan provides for payments, not to exceed 5% of the Company's consolidated earnings before income taxes and before deducting payments under the Plan or any other incentive compensation arrangement, to executive officers and other supervisory personnel if such earnings goal is achieved. The amount of the bonus is based on a percentage of the employee's base salary, and for executive officers the percentage ranges from 35% to 100%. The percentage is higher for more senior executive officers as a greater portion of senior executives' compensation is tied to the achievement of pre-tax earnings goals. In the event the pre-tax earnings goal is exceeded, the amount of the bonus increases by 2% for each 1% by which the goal is exceeded, to a maximum of 50% additional bonus for exceeding the goal by 25%. If the pre-tax earnings goal is not achieved, the amount of the bonus decreases by 5% for each 1% by which the goal is not achieved, with no bonus being paid if pre-tax earnings are below 90% of the goal.

Except for the Chairman of the Board and CEO and the Vice Chairman and Chief Financial and Administrative Officer, the annual individual performance rating of each executive officer by that officer's supervisor may increase or decrease the amount of bonus paid. The performance rating is based on a variety of criteria, including the effectiveness of the officers in executing their managerial responsibilities and their impact on the financial results of the Company (such as sales, pre-tax earnings and Shareholders' return on average equity). The Compensation Committee reviews and approves the payment of bonuses under the Incentive Profit Sharing Plan. No bonus was earned under the Incentive Profit Sharing Plan for fiscal 2005 as the Company failed to meet the pre-established net earnings goals. See "Executive Compensation - Summary Compensation Table" above.

Stock Options. To further link management's compensation to its performance in creating value for Shareholders, as evidenced by increases in the Company's stock price, executive officers may receive grants of stock options, typically on an annual basis. The Compensation Committee is responsible for the oversight of the stock option plan. In determining the number of options to be granted, the Compensation Committee considers the executive's base salary, level of responsibility and annual individual performance, as well as the number of options granted in prior years. Under the 1989 Plan, the exercise price for each option is the fair market value per share of Common Stock on the date of the grant. Fair market value per share is the average of the highest price and lowest price at which the Common Stock is sold regular way on the NYSE on the date of the grant. Options have a term of five years and may not be exercised for at least two years from the date of the grant. Thereafter, each option becomes exercisable in cumulative installments of not more than 40% of the number of shares subject to the option after two years, 70% after three years and 100% after four years. Such vesting schedule encourages executives to remain in the employ of the Company. With limited exceptions, no option is exercisable unless the optionee has been continuously employed by the Company from the date of grant to the date of exercise. As a result of the amendment to the 1989 Plan, which amendment was approved by the Shareholders at last year's annual meeting, the options of qualifying retirees continue to vest and the retirees may, following their retirement, exercise certain options granted prior to retirement so long as they comply with the 1989 Plan requirements.

During fiscal 2005, the Company redesigned its long-term incentive compensation program effective for the fiscal year ending August 26, 2006 ("fiscal 2006"), and subsequent fiscal years. Under the new program, the Company intends to provide long-term incentive compensation through a combination of stock options and certain performance share rights to be granted under a new incentive plan, subject to Shareholder approval. See

“Proposal No. 2 – Approval of 2006 Plan.” The Common Stock subject to performance share rights will be awarded only if the Company meets certain performance levels during defined performance periods of up to three fiscal years. The Compensation Committee believes that awarding a balanced mix of stock options and performance share rights will further enhance the pay-for-performance objective of the Company’s overall compensation philosophy, while reducing the Company’s dependence on stock option grants as a major component of compensation packages.

Compensation of Chief Executive Officer. The base salary of the Chief Executive Officer is established by the Compensation Committee annually based on consideration of the same general factors described above for the determination of other executive officers’ base salaries. The Compensation Committee also considers the value of any other benefits provided to the Chief Executive Officer. For both fiscal 2005 and fiscal 2006, Mr. Levine’s base salary was established at \$725,000.

The incentive compensation element of the Chief Executive Officer’s compensation is based on the Company’s achievement of its pre-tax earnings goal. Under the Company’s Incentive Profit Sharing Plan, Mr. Levine’s bonus was based on 100% of his base salary for fiscal 2005 and is based on the same percentage of his base salary for fiscal 2006. The amount of the bonus may increase or decrease based on the level of pre-tax earnings in the manner described above with respect to the bonus for other executive officers. For fiscal 2005, no bonus was paid to Mr. Levine under the Incentive Profit Sharing Plan as the Company failed to achieve the pre-tax earnings goal.

In determining Mr. Levine’s base salary and bonus percentage, the Compensation Committee also considered options he received under the 1989 Plan. As described under the heading “Option Grants During the Fiscal Year Ended August 27, 2005,” Mr. Levine received options to purchase 200,000 shares in October 2004. In September 2005, Mr. Levine was granted options to purchase 150,000 shares and, subject to Shareholder approval of the 2006 Plan, was awarded 37,500 performance share rights with a three year performance period and 12,500 performance share rights with a one-year performance period. See “Proposal No. 2 – Approval of 2006 Plan.” The Compensation Committee also considered that the Company’s only retirement plan or similar benefit for the Chief Executive Officer or any other executive officers to which the Company contributes is a 401(k) Plan.

Deductibility of Compensation. Section 162(m) of the Internal Revenue Code (the “Code”) provides that publicly held companies may not deduct in any taxable year compensation in excess of \$1 million paid to the Chief Executive Officer or any of the four other highest paid executive officers which is not “performance-based,” as defined in Section 162(m). The Shareholders have approved both the 1989 Plan and the Incentive Profit Sharing Plan for the purpose of preserving the future deductibility of all compensation paid under said Plans. The Compensation Committee fully considers Section 162(m) when determining executive compensation packages and the Company believes that all applicable executive officer compensation paid in fiscal 2005 met the deductibility requirements of Section 162(m).

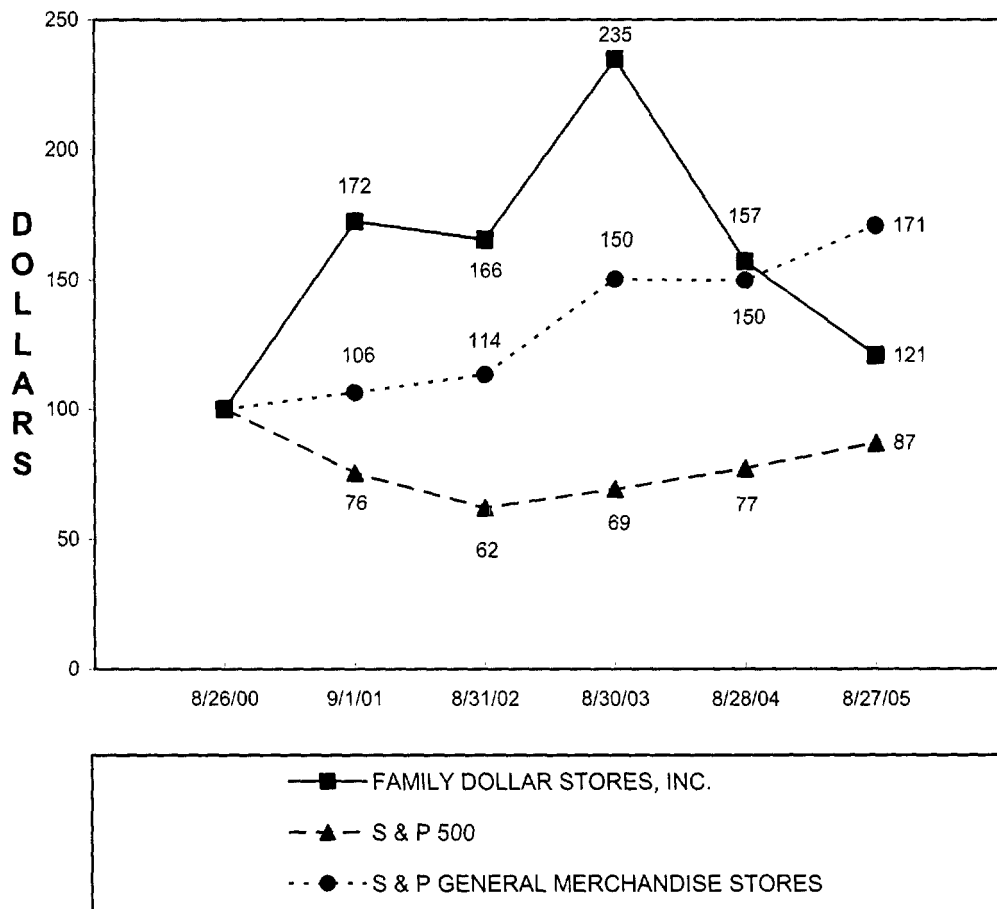
This report is submitted by Mark R. Bernstein, Sharon Allred Decker and James G. Martin as the members of the Compensation Committee.



## STOCK PERFORMANCE GRAPH

The following graph sets forth the yearly percentage change in the cumulative total shareholder return on the Company's Common Stock during the five fiscal years ended August 27, 2005, compared with the cumulative total returns of the S&P 500 Index and the S&P General Merchandise Stores Index. The comparison assumes that \$100 was invested in the Company's Common Stock on August 26, 2000, and, in each of the foregoing indices on August 31, 2000, and that dividends were reinvested.

**COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN  
Among Family Dollar Stores, Inc., the S & P 500 Index  
and the S & P General Merchandise Stores Index**



## OWNERSHIP OF THE COMPANY'S SECURITIES

### Ownership by Directors and Officers

The following table sets forth, for each director of the Company, each of the Named Executive Officers, and all executive officers and directors as a group, the number of shares beneficially owned and the percent of Common Stock so owned, all as of November 1, 2005:

<u>Name</u>	<u>Amount and Nature of Beneficial Ownership (#)(1)</u>	<u>Percent of Common Stock</u>
Mark R. Bernstein	15,621(2)	*
Sharon Allred Decker	1,813	*
Edward C. Dolby	2,304	*
Glenn A. Eisenberg	1,904	*
Howard R. Levine	10,306,816(3)	6.6%
George R. Mahoney, Jr.	609,922	*
James G. Martin	3,186	*
R. James Kelly	488,000	*
Charles S. Gibson, Jr.	142,000	*
Janet G. Kelley	200	*
Irving Neger	97,616	*
R. David Alexander, Jr.	119,500	*
All Executive Officers and Directors of the Company as a Group (16 persons)	11,978,985	7.7

\* Less than one percent.

- (1) All shares are held with sole voting and investment power, except that Mr. Levine does not have voting or investment power with respect to 6,512,395 shares held in irrevocable trusts for his benefit by Bank of America, N.A., as Trustee, as set forth in note (2) below. These numbers include shares for which the following persons have the right to acquire beneficial ownership, as of November 1, 2005, or within 60 days thereafter, pursuant to the exercise of stock options: (i) Mr. Levine – 472,500 shares; (ii) Mr. Mahoney – 141,500 shares; (iii) Mr. Kelly – 265,000 shares; (iv) Mr. Gibson – 130,000 shares (v) Mr. Neger – 92,000 shares; (vi) Mr. Alexander – 99,500 shares; and (vii) all executive officers and directors as a group – 1,278,500 shares. These numbers also include certain options that are vested as a result of the Company's stock option acceleration program, as further described on the Company's Form 8-K report filed with the SEC on August 24, 2005.
- (2) These numbers include 10,660 shares held under the Parker, Poe, Adams & Bernstein L.L.P. Profit Sharing Plan, but do not include 18,250 shares owned by Mr. Bernstein's wife. Mr. Bernstein disclaims beneficial ownership of the shares owned by his wife.
- (3) These numbers include 6,512,395 shares included in the table "Ownership by Others," which appears below as being held in irrevocable trusts for the benefit of Mr. Levine by Bank of America, N.A. as Trustee. They do not include 187,284 shares listed in said table which are held in irrevocable trusts for the benefit of Mr. Levine's child by Bank of America, N.A. as Trustee, or 1,025 shares owned by Mr. Levine's wife. Mr. Levine disclaims beneficial ownership of the shares owned by his wife.

The Company believes that its executive officers should hold a relevant equity interest in the Company. Consequently, the Board has recently adopted stock ownership guidelines for all officers of the Company who hold the position of Vice-President or above. Under these guidelines, those officers are expected to achieve ownership of the Company's Common Stock valued at a multiple of the officer's annual base compensation, ranging from one times salary for Vice Presidents to five times salary for the Chief Executive Officer. Pending achievement of these ownership goals, officers will be required to retain 25% of the net value (after the exercise price of any options and after applicable taxes) of any equity award.

### Ownership by Others

Based on filings with the SEC and other information, the Company believes that, as of the dates set forth below, the following additional Shareholders beneficially owned more than 5% of the Company's Common Stock:

<u>Name and Address</u>	<u>Amount and Nature of Beneficial Ownership (#)</u>	<u>Percent of Common Stock (1)</u>
Bank of America Corporation 100 North Tryon Street Charlotte, North Carolina 28255	15,075,907(2)	9.7%
T. Rowe Price Associates, Inc. 100 E. Pratt Street Baltimore, MD 21202	11,915,246(3)	7.7%

- 
- (1) Based on the number of shares of Common Stock owned by each Shareholder as set forth above and the Company's outstanding Common Stock as of November 1, 2005.
  - (2) Based on the Schedule 13G filed by Bank of America Corporation and its affiliates, as of December 31, 2004, 14,580,044 of such shares were held with shared voting power and 14,944,135 of such shares were held with shared dispositive power by Bank of America Corporation; 14,316,832 of such shares were held with shared voting power and 14,667,328 of such shares were held with shared dispositive power by NB Holdings Corporation; 14,162,219 of such shares were held with sole voting power, 113,521 of such shares were held with shared voting power, 14,532,664 of such shares were held with sole dispositive power and 93,572 of such shares were held with shared dispositive power by Bank of America, N.A.; 88,577 of such shares were held with sole voting and dispositive power by Banc of America Capital Management, LLC; 41,092 of such shares were held with shared voting and dispositive power by NationsBank Montgomery Holdings Corporation; 41,092 of such shares were held with sole voting and dispositive power by Bank of America Securities, LLC; 240,190 of such shares were held with sole voting power, 23,022 of such shares were held with shared voting power, 193,654 of such shares were held with sole dispositive power and 83,153 of such shares were held with shared dispositive power by Fleet National Bank; 22,762 of such shares were held with shared voting and dispositive power by Columbia Management Group, Inc.; and 22,762 of such shares were held with sole voting and dispositive power by Columbia Management Advisors, Inc. These shares include 6,512,395 shares held in trusts for the benefit of Mr. Levine, as noted in "Ownership by Directors and Officers," above.
  - (3) Based solely on the Schedule 13G filed by T. Rowe Price Associates, Inc. as of December 31, 2004, all of the shares listed above were held with sole power to dispose and 2,138,149 of such shares were held with sole power to vote.

### RELATED TRANSACTIONS

During fiscal 2005, the Company purchased apparel for use by the Company's store associates and other merchandise, at a cost of \$1,210,790, from a company owned by Eric Lerner, Howard R. Levine's brother-in-law. The Company expects to engage in similar transactions during fiscal 2006. The Company believes that these purchases were made on terms comparable to those that would be obtained in independent arms-length transactions with unrelated parties.

Pursuant to a Retirement Agreement dated as of September 30, 2002, between the Company and Mr. Leon Levine, the former Chairman of the Board of the Company and the father of Howard R. Levine, the Company provides certain office space to Mr. Leon Levine (or, in the event of his death, to his wife) and to certain of his assistants and/or advisors; continuing health care coverage for Mr. Leon Levine and certain of his family members; Company-paid personal liability umbrella insurance coverage; and use of the Company's airplanes for up to 30 hours per year. The Company accrued approximately \$1,285,000 in fiscal 2002 for the total value of these benefits to be received over the term of the Agreement.

## **PROPOSAL NO. 2**

### **APPROVAL OF 2006 INCENTIVE PLAN**

The Board of Directors has adopted, subject to and effective upon Shareholder approval, the Family Dollar Stores, Inc. 2006 Incentive Plan (the "2006 Plan"). The Board of Directors recommends that the Shareholders approve the 2006 Plan in order to provide greater flexibility in developing equity awards that promote the Company's compensation philosophy and to allow the Company to continue to deduct certain payments made to executive officers of the Company under the federal tax laws, as discussed below. If the Shareholders approve the 2006 Plan, it will replace the 1989 Plan and no additional awards will be made under the 1989 Plan.

#### **Reasons for the 2006 Plan**

The Compensation Committee's philosophy is that the Company should provide competitive compensation packages to its employees that are designed to promote the success and enhance the value of the Company by linking the personal interests of employees, officers, directors and consultants of the Company to those of Company Shareholders by providing such persons with an incentive for outstanding performance, and by linking that performance to compensation. See "Report of the Compensation Committee of the Board of Directors on Executive Compensation." The provisions of the 2006 Plan will enable the Company to offer employees equity awards that are intended to more closely align pay with performance while continuing to align the interests of the employees with Shareholders through the ownership of stock. The 1989 Plan limited awards to non-qualified stock option grants and, therefore, limited the Company's flexibility in developing such equity award programs.

#### **Description of 2006 Plan**

A summary of the 2006 Plan appears below. This summary is qualified in its entirety by reference to the text of the 2006 Plan, a copy of which is attached to this Proxy Statement as Exhibit I.

*General.* The 2006 Plan is an "omnibus" plan that provides for a variety of cash and/or equity and equity-based award vehicles, including stock options, performance shares, stock appreciation rights, restricted stock, restricted stock units and other stock or cash-based awards. The 2006 Plan is designed to provide the Company flexibility in the implementation of its equity compensation programs. Shareholder approval of the 2006 Plan will also allow the Compensation Committee to continue to grant awards that qualify as "performance-based" compensation under Code Section 162(m), preserving the Company's tax deduction for such compensation. If the 2006 Plan is approved by the Shareholders at the Annual Meeting, the 2006 Plan will become effective that same day and will expire on the tenth anniversary of such approval, and no further awards will be made under the 1989 Plan or the Incentive Profit Sharing Plan.

*Administration.* The 2006 Plan will be administered by the Compensation Committee of the Board (the "Plan Committee") or, at the discretion of the Board from time to time, the 2006 Plan may be administered by the Board.

The Plan Committee has, with certain limitations, the exclusive power to, among other things, establish the design of awards, determine performance measures, grant awards, designate participants, determine the type or types of awards to be granted to each participant and to determine the terms and conditions of any award granted under the 2006 Plan. To the extent permitted by applicable law, the Plan Committee may delegate its authority to any individual or committee of individuals.

*Eligibility for Participation.* Any employee, officer, consultant or director of the Company or its subsidiaries or affiliates may be selected to receive awards under the 2006 Plan, subject to certain limitations on the grant of incentive stock options. The Company expects that approximately 200-300 people, including the Company's current seven executive officers, will receive awards under the 2006 Plan each year. The 2006 Plan provides that the Company's directors are eligible for awards under the Plan. However, the Company awards stock to the directors under the Outside Directors Stock Plan (see "Compensation of Directors") and does not currently expect to make awards to directors under the 2006 Plan.

*Types of Awards.* The 2006 Plan provides for the grant of cash awards, stock options ("Options") (including both incentive stock options ("ISOs") and nonqualified stock options ("NQSOs")), stock appreciation rights ("SARs"), Performance Awards (including "performance share rights" as described below), Restricted Stock and Restricted Stock Units, Deferred Stock Units and Dividend and Interest Equivalents, each of which are briefly described below. Reference is made to the text of the 2006 Plan for a complete description of each of the above award types.

Options. Both ISOs and NQSOs may be granted under the 2006 Plan. The exercise price for Options under the 2006 Plan cannot be less than the fair market value at the grant date and no Option may have a term beyond 10 years. ISOs are subject to further restrictive provisions as set forth in the 2006 Plan, and no more than five million ISOs may be granted under the 2006 Plan. All other terms and conditions will be established by the Plan Committee.

Stock Appreciation Rights. SARs may be granted on terms established by the Plan Committee, provided that the grant price of SARs cannot be less than the fair market value at the grant date. Upon the exercise of SARs, the participating employee will receive cash or Common Stock equal to the difference between the fair market value at the exercise date and the fair market value at the grant date.

Performance Awards. The Company may grant rights to receive Performance Shares, Performance Units or Performance-Based Cash Awards based upon the achievement of performance goals and on such terms and conditions as may be selected by the Plan Committee, including the establishment of various performance goals, as discussed below.

Restricted Stock. Restricted stock awards may be made on such terms as the Plan Committee establishes, including provisions for vesting based on employment and/or upon the achievement of performance goals.

Deferred Stock Units. The 2006 Plan provides that the Company may grant Deferred Stock Units, which entitle a participant to receive shares of Common Stock (or the equivalent value in cash or other property) at a future time.

Dividend Interest Equivalents. The Plan authorizes the grant of Dividend Interest Equivalents, which entitle a participant to receive payments equal in value to the cash dividends that would have been paid for all or a portion of the number of shares, subject to any hypothetically outstanding shares.

Other Awards. The 2006 Plan authorizes other cash and/or stock-based awards on the terms and conditions established by the Plan Committee.

*Available Shares.* The aggregate number of shares of Common Stock available under the Plan will be 12,000,000. After the cancellation of shares available under the 1989 Plan, this will result in a net increase of roughly 7.7 million shares. Shares subject to awards that are canceled, terminated, expire, are forfeited or lapse for any reason will again be available for issuance under the 2006 Plan. Shares subject to awards settled in cash will also be available for issuance under the Plan. The number of shares available under the Plan will be adjusted in the event of corporate events or transactions involving the Company such as a stock dividend, stock split, extraordinary cash dividend, recapitalization, reorganization, merger, consolidation, split-up, spin-off, combination or exchange of shares, and the Plan Committee may make appropriate adjustments to outstanding awards to reflect such transactions.

*Internal Revenue Code Section 162(m).* Section 162(m) of the Code generally places a \$1 million annual limit on a company's tax deduction for compensation paid to the chief executive officer and the four most highly compensated officers, referred to as the "covered individuals." This limitation does not apply, however, to "qualified performance-based compensation." Because Options or SARs granted under the 2006 Plan must have an exercise price equal to at least fair market value at the date of grant, are granted to covered individuals by a compensation committee consisting of at least two outside directors, and because the 2006 Plan limits the number of shares that may be the subject of awards granted to any employee during any calendar year, compensation from the exercise of Options or SARs should qualify as "qualified performance-based compensation" for purposes of Section 162(m).

In addition, the 2006 Plan authorizes the Plan Committee to make awards of Restricted Stock Shares, Restricted Stock Units, Performance Shares, Performance Units or cash-based Performance Awards that are conditioned on the satisfaction of performance criteria. For those awards to meet the requirements of the "qualified performance-based compensation" exception to Section 162(m), the Plan Committee must establish the applicable performance conditions prior to or within a specified period after the start of the applicable performance period. Performance measures may be based upon the Company's performance, individual performance, performance of a division, region, department or function within the Company, or may be measured against a relative peer group or prior performance. Performance measures may include the following measures for this purpose:

- Revenue
- Sales
- Profit (net profit, gross profit, operating profit, economic profit, profit margins or other corporate profit measures)
- Earnings on a pre-tax or post-tax basis (EBIT, EBITDA, earnings per share, earnings growth or other corporate earnings measures)
- Net income (before or after taxes, operating income or other income measures)
- Cash (cash flow, cash generation or other cash measures)
- Stock price or performance
- Total shareholder return (stock price appreciation plus reinvested dividends divided by beginning share price or other measures of return)
- Financial return measures (including, but not limited to, dividends, return on assets, capital, equity or sales, and cash flow return on assets, capital, equity or sales)
- Market share measures
- Improvements in capital structure
- Expenses (operating expense, expense management, expense ratio, expense efficiency ratios or other expense measures)

- Business expansion or consolidation (acquisitions and divestitures)
- Internal rate of return or increase in net present value
- Working capital targets relating to inventory and/or accounts receivable
- Planning accuracy (as measured by comparing planned results to actual results)
- Productivity improvement
- Inventory measures (turns, reduction or shrink)
- Customer relations (count, frequency, size of basket or attitude)
- Compliance goals (employee turnover, social goals, diversity goals, safety programs, regulatory or legal compliance)
- Goals relating to business expansion, acquisitions and divestitures

The performance conditions will be stated in the form of an objective, nondiscretionary formula, and the Plan Committee will certify in writing the attainment of those performance conditions prior to any payment or distributions with respect to awards. The Plan Committee may, in its discretion, adjust downward any award.

In no event may an individual receive awards under the 2006 Plan for a given calendar year (i) covering in excess of 500,000 shares of Common Stock or (ii) in the case of cash awards, in excess of \$1,000,000.

So that Options and SARs granted under the 2006 Plan qualify as performance-based compensation, and to permit the Plan Committee to grant other awards under the 2006 Plan that are intended to qualify for the exclusion, the 2006 Plan is being submitted to the Shareholders for approval. A vote in favor of approving the 2006 Plan will be a vote approving all the material terms and conditions of the Plan for purposes of the performance-based exemption under Section 162(m), including the performance measures, eligibility requirements and limits on various awards, in each case as described above.

*Change In Control.* In the event of a change in control (as defined in the 2006 Plan), if the acquiring company does not assume the obligation to perform under the 2006 Plan with respect to outstanding awards or for awards that are assumed by the acquiring company, or if within two years following the change in control, a participating employee is terminated from employment without cause or the participant resigns for good reason (as such terms are defined in the 2006 Plan), then: (i) the vesting of outstanding Options and other awards or rights shall be accelerated; (ii) time-based vesting restrictions on outstanding awards shall lapse; and (iii) the target payout opportunities attainable under outstanding performance-based awards shall be deemed to have been fully earned as of the effective date of the change in control based upon the greater of (A) the “target” level for performance awards, or (B) the actual level of performance against the target. In either such case, participants will be paid a prorated award based upon the length of the performance period that has elapsed prior to the date of the change in control or termination of employment. In addition, if a performance-based award is not assumed by the acquiring company, the participant will have the opportunity to earn the remaining portion of the award not paid out upon the change in control.

*Death, Disability or Retirement.* At the 2005 Annual Meeting, the Shareholders approved amendments to the 1989 Plan which provided that, with certain exceptions and subject to further requirements, for qualifying retirees, options outstanding at retirement would continue to vest and be exercisable following such retirement in the same manner as though the retiree were still an employee of the Company. The Compensation Committee anticipates adopting similar provisions pursuant to the 2006 Plan for Options and has adopted guidelines for the pro-rata payment of certain performance share rights awards to qualifying retirees. The Compensation Committee anticipates that, upon Shareholder approval of the 2006 Plan, it will also adopt guidelines for accelerated vesting of Options upon the death of a participating employee and for pro-rata payments of performance share rights awards upon the death or disability of a participating employee.

### *Other Significant Features*

- The 2006 Plan has a fixed-share authorization limit of 12 million shares, as opposed to an “evergreen” feature.
- Repricing of options issued under the 2006 Plan is not permitted without Shareholder approval.
- Discounted stock options are prohibited.

*Tax Treatment of Awards.* The following discussion is only a summary of the effect of U.S. federal income taxation upon participants and the Company for the grant and/or exercise of various awards in the 2006 Plan. Participants in the 2006 Plan may also have consequences under state and local tax laws which vary from the federal tax consequences described in this proxy. Information contained in this proxy is not intended as tax advice and prospective participants in the 2006 Plan should contact their personal tax advisors to ascertain the specific tax consequences applicable to them.

*Incentive Stock Options.* In general, the grant of an ISO results in no taxable ordinary income to the participant and no deduction to the Company at the time the ISO is granted or exercised. If the participant holds the common shares received as a result of the exercise of an ISO for at least two years from the date of the grant and one year from the date of exercise, then the gain realized on disposition of the common shares is treated as a long-term capital gain. If the common shares are disposed of during this period, however, then the participant must include in income, as compensation for the year of the disposition, an amount equal to the excess, if any, of the fair market value of the common shares upon exercise of the stock option over the stock option price. The excess, if any, of the sale price over the fair market value of the Company’s common stock on the date of exercise will be a short-term capital gain. The Company will be entitled to an income tax deduction equal to the amount of ordinary income recognized by the participant with respect to the exercised ISO. The deduction, in general, will be allowed for the taxable year of the Company in which such ordinary income is recognized by the participant.

Non-Qualified Stock Options. Generally, an NQSO results in no taxable income to the participant and no deduction to the Company at the time of the grant. However, a participant exercising an NQSO will, at that time, realize taxable compensation in the amount of the difference between the stock option price and the then fair market value of the Company’s Common Stock. Provided that certain reporting requirements are satisfied, the Company will be entitled to a deduction for federal income tax purposes in an amount equal to the taxable compensation recognized by the participant. Upon the sale or disposition of shares acquired pursuant to an NQSO, the difference between the proceeds realized and the participant’s basis in the shares will be treated as a long-term or short-term capital gain (or loss), depending upon the holding period of the common shares.

Stock Appreciation Rights. Generally, no taxable income is recognized by a participant receiving a non-vested SAR payable in stock at the time the SAR is granted. Upon exercise and settlement, the spread between the then current market value of the Company’s Common Stock and the base price of the SAR will be taxed as ordinary income to the participant. The Company will be entitled to a deduction equal to the amount of ordinary income the participant is required to recognize as a result of the settlement.

Other Awards. The current United States federal income tax consequences of other awards authorized under the 2006 Plan are generally in accordance with the following: (i) the fair market value of restricted stock is generally subject to ordinary income tax at the time the restrictions lapse, unless the recipient elects to accelerate recognition as of the date of grant and (ii) the amount of cash paid (or the fair market value of the common shares issued) to settle restricted stock units and performance units is generally subject to ordinary income tax. Cash awards will be taxable income to the recipient at the date of payment. In each of the foregoing cases, the Company will generally be entitled to a corresponding federal income tax deduction at the same time the participant recognizes ordinary income.



Withholding for Payment of Taxes. The 2006 Plan provides for the withholding and payment by a participant of any payroll or withholding taxes required by applicable law. The 2006 Plan permits a participant to satisfy this requirement, subject to the terms of the 2006 Plan, by having the Company withhold from the participant a number of shares of Common Stock otherwise issuable under the award having a fair market value equal to the amount of applicable payroll and withholding taxes.

## **2006 Compensation Awards**

In anticipation of the approval of the 2006 Plan by the Shareholders, the Company recently completed its annual compensation award process for fiscal 2006, which, for selected employees, included: (i) stock option grants made under the 1989 Plan; (ii) annual cash bonus awards made under the Incentive Profit Sharing Plan; and (iii) contingent grants of performance share rights awards, as described fully below, under the 2006 Plan, subject to Shareholder approval of the 2006 Plan. If the 2006 Plan is not approved by the Shareholders, the Company expects to grant additional stock options to employees in replacement of the contingent awards of performance share rights, which will be considered null and void.

The Company currently expects that future awards under the 2006 Plan will be similar to the annual awards of cash bonus opportunities, Options, and performance share rights that were recently awarded to selected employees. Under both the current Incentive Profit Sharing Plan, which was previously approved by the Shareholders, and the 2006 Plan, employees will have the opportunity to receive an annual cash payment equal to a percentage of their base salary, generally ranging from 10% to 100%, if the Company achieves certain net earnings goals and subject to adjustments for personal performance (except in the case of certain executive officers). In addition, Options were granted under the 1989 Plan with a term of five years which will vest in increments of 40% on the second anniversary date of the grant, and an additional 30% on each of the third and fourth anniversary dates of the grant. The Company currently anticipates that future Option grants will be on the same vesting terms.

The compensation awards made to selected employees in the fall of 2005 also included contingent awards of performance share rights ("PSRs"). If the Shareholders approve the 2006 Plan, the Company currently plans to include PSRs in future compensation packages. The PSRs are awards for the grant of a number of shares of the Company's Common Stock if the Company achieves certain levels of performance against a selected peer group of companies (presently set at twenty) for pre-tax net income growth ("earnings growth") and average annual return on equity ("ROE"). Each participating employee is advised of a "target" number of shares that will be awarded at the end of the relevant performance period if the Company is at the 50th percentile in relation to the peer group for ROE and earnings growth (which are equally weighted). If the Company's performance relative to the peer group is above or below the 50th percentile, the number of shares of Common Stock actually awarded to the employee will be adjusted upward or downward, respectively. No awards will be made if the Company's relative performance is below the 30th percentile, and awards may be increased to twice the "target" award if the Company's relative performance is above the 90th percentile. The performance period for the PSRs will generally be three years, but the Company will make one-year performance period awards in each of the 2006 and 2007 fiscal years in order to facilitate employee understanding of the new metrics.

## **Benefits to Named Executive Officers and Others**

If the 2006 Plan is approved by the Shareholders, future awards of equity interests to employees will be made under the Plan. All employees of the Company who are selected to participate in the Company's equity compensation programs, including executive officers, will receive the potential benefit of grants and awards under the Plan.

Although the amount of future awards is not determinable, the following table sets forth information regarding the awards which would have been received by or allocated to the "Named Executive Officers" of the Company, individually and in groups, for the last fiscal year had the 2006 Plan been in effect, based upon the actual awards of Options and PSRs granted to them in September, contingent upon the approval of the 2006 Plan by the Shareholders. Option grants were made under the 1989 Plan, but are included herein since the number of Option grants has been reduced to reflect the complementary PSRs contingently granted. No awards of Options or PSRs were granted to either of Messrs. Alexander or Mahoney, as they were no longer with the Company at the time of the September awards.

#### Family Dollar Stores, Inc. 2006 Incentive Plan Benefits

<u>Name and Position (1)</u>	<u>Number of PSR Target Awards (2)</u>		<u>Number of Options(3)</u>
	<u>1-Year</u>	<u>3-Year</u>	
Howard R. Levine Chairman of the Board & Chief Executive Officer	12,500	37,500	150,000
R. James Kelly Vice Chairman, Chief Financial & Administrative Officer	8,000	24,000	95,000
Charles S. Gibson, Jr. Executive Vice President- Logistics	2,500	7,500	35,000
Janet G. Kelley Senior Vice President- General Counsel and Secretary	1,334	4,000	22,000
Irving Neger Former Senior Vice President- Merchandising (4)	1,334	4,000	17,000
Current Executive Officers	30,519	91,550	372,000
Non-Executive Director Group	0	0	0
Non-Executive Officer Employees (26 persons)	12,303	36,875	159,500

- 
- (1) The Company's non-management directors are currently not granted awards under the Plan. See "Compensation of Directors."
- (2) The amounts set forth in the table assume that the PSRs are awarded at the "target" level. The actual dollar value of the PSRs ultimately will be dependent on the actual number of shares of Common Stock issued (based on performance during the applicable period as described under "2006 Compensation Awards," above) and the fair market value of the Common Stock on the date of such issuance. As of November 1, 2005, the closing price of the Company's Common Stock was \$21.88 per share.
- (3) The actual value of Options will be dependent upon the fair market value of the Company's Common Stock at the date of the exercise of the Options. The Options set forth in the table have an exercise price of \$19.75 per share, which was the fair market value of the Company's Common Stock on the grant date.
- (4) Mr. Neger's stock option awards have been cancelled, effective upon his termination of employment with the Company. If the Shareholders approve the 2006 Plan, Mr. Neger will receive a pro-rata award of the PSRs.

## Shareholder Approval

The affirmative vote of a majority of the Common Stock present or represented and entitled to vote at the Annual Meeting is required for approval of the 2006 Plan. If the 2006 Plan is not approved by the Shareholders, the Company expects to grant additional stock options to participating employees in replacement of the contingent awards of PSRs (which will be void) and, in the future, to grant stock options under the 1989 Plan and to award annual cash bonus opportunities under the Incentive Profit Sharing Plan.

## Recommendation of the Board of Directors

The Board of Directors recommends that the Shareholders vote FOR the adoption of the 2006 Plan.

### PROPOSAL NO. 3

#### RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTANTS

The Audit Committee of the Board of Directors has appointed the firm of PricewaterhouseCoopers LLP ("PwC") as independent registered public accountants to audit and report on the consolidated financial statements of the Company and its subsidiaries for fiscal 2006, and to perform such other appropriate accounting and related services as may be required by the Audit Committee. The affirmative vote of the holders of a majority of the shares of Common Stock present or represented by proxy at the Annual Meeting and entitled to vote in respect thereto is required to ratify the selection of PwC for the purposes set forth above. The Audit Committee and the Board of Directors recommend that the Shareholders vote FOR ratification of the appointment of PwC. If the Shareholders do not ratify the appointment of PwC, the appointment of the independent registered public accountants will be reconsidered by the Audit Committee. PwC served as the Company's independent registered public accountants for the fiscal year ended August 31, 1991, and for each subsequent fiscal year. Representatives of PwC are expected to be present at the Annual Meeting and will have an opportunity to make a statement if they desire to do so and to respond to appropriate questions.

#### Independent Registered Public Accounting Firm's Fees and Services

The following sets forth fees billed for the audit and other services provided by PwC for fiscal 2005 and 2004:

<i>Fee Category</i>	<i>Fiscal 2005 Fees</i>	<i>Fiscal 2004 Fees</i>
Audit Fees (1)	\$602,686	\$186,100
Audit-Related Fees (2)	\$ 70,261	\$ 39,850
Tax Fees	0	0
All Other Fees	0	0
Total	<u>\$672,947</u>	<u>\$225,950</u>

(1) Includes fees for audits of annual financial statements and reviews of the related quarterly financial statements and, in fiscal 2005, review of the Company's internal controls.

(2) Includes fees for audit related work in connection with employee benefit plans of the Company, review of an SEC comment letter received by the Company in the ordinary course of business and consultation related to the Company's restatement of prior years' financial statements as reported on Forms 10-K/A and 10-Q/A, filed with the SEC on April 15, 2005.

All services rendered by PwC are permissible under applicable laws and regulations, and all such services were pre-approved by the Audit Committee. The Audit Committee Charter requires that the Committee pre-approve the services to be provided by PwC and the Audit Committee has not delegated that approval authority.

### **Recommendation of the Board of Directors**

The Board of Directors recommends that the Shareholders vote FOR the ratification of the appointment of PwC as the Company's independent registered public accountants for fiscal 2006.

### **SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE**

Section 16(a) of the Securities Exchange Act of 1934 requires the Company's directors and executive officers and persons who own more than ten percent of the Company's Common Stock (collectively, "Reporting Persons") to file with the SEC and NYSE initial reports of ownership and reports of changes in ownership of the Common Stock, and to furnish the Company with copies of such reports. To the Company's knowledge, which is based solely on a review of the copies of such reports furnished to the Company and written representations from Reporting Persons that no other reports were required, all Reporting Persons complied with all applicable filing requirements during fiscal 2005, except that Mrs. Sharon Allred Decker inadvertently failed to timely file a Form 4 report with respect to the sale of a de minimis number of shares sold by her broker without her knowledge in order to meet margin requirements.

### **SHAREHOLDER PROPOSALS**

Proposals of Shareholders intended to be presented at the next Annual Meeting of Shareholders in January 2007 (the "2007 Annual Meeting"), and to be included in the Proxy Statement and form of proxy pursuant to Rule 14a-8 under the Securities Exchange Act of 1934 (the "Act"), must be received by the Company on or before August 3, 2006. If the Company receives notice of any Shareholder proposal after October 16, 2006, such proposal will be considered untimely pursuant to Rules 14a-4 and 14a-5(e) under the Act, and the persons named in the proxies solicited by the Board of Directors of the Company for the 2007 Annual Meeting may exercise discretionary voting power with respect to such proposal. Additionally, the Company's Bylaws require that any Shareholder who intends to make a nomination or bring any other matter before the 2007 Annual Meeting must deliver notice of such intent to the Company not later than October 21, 2006, nor earlier than September 21, 2006. Any such proposals or notices should be in writing and should be sent by certified mail, return receipt requested, to the Secretary, Family Dollar Stores, Inc., P.O. Box 1017, Charlotte, North Carolina 28201-1017. Submitting a Shareholder proposal does not guarantee that the Company will include such proposal in its next proxy statement. The Board reviews all Shareholder proposals and determines whether further action is required.

### **OTHER MATTERS**

Management knows of no other matters to be brought before the Annual Meeting. However, if any other matters do properly come before the Annual Meeting, it is intended that the shares represented by the proxies in the accompanying form will be voted in accordance with the best judgment of the person voting the proxies. Whether or not Shareholders plan to attend the Annual Meeting, they are respectfully urged to sign, date and return the enclosed proxy which will, of course, be returned to them at the Annual Meeting if they are present and so request.

## **EXHIBIT I**

### **FAMILY DOLLAR STORES, INC. 2006 INCENTIVE PLAN**

#### **ARTICLE 1 PURPOSE**

1.1. **GENERAL.** The Family Dollar Stores, Inc. 2006 Incentive Plan is designed to promote the success, and enhance the value, of the Company, by linking the personal interests of employees, officers, directors and consultants of the Company or any Affiliate (as defined below) to those of Company stockholders and by providing such persons with an incentive for outstanding performance. The Plan is further intended to provide flexibility to the Company in its ability to motivate, attract, and retain the services of employees, officers, directors and consultants upon whose judgment, interest, and special effort the successful conduct of the Company's operation is largely dependent. Accordingly, the Plan permits the grant of incentive awards from time to time to selected employees, officers, directors and consultants of the Company and its Affiliates.

#### **ARTICLE 2 DEFINITIONS**

2.1. **DEFINITIONS.** When a word or phrase appears in this Plan with the initial letter capitalized, and the word or phrase does not commence a sentence, the word or phrase shall generally be given the meaning ascribed to it in this Section unless a clearly different meaning is required by the context. The following words and phrases shall have the following meanings:

(a) "Affiliate" means (i) any Subsidiary or Parent, or (ii) an entity that directly or through one or more intermediaries controls, is controlled by or is under common control with, the Company, as determined by the Committee.

(b) "Award" means any Option, Stock Appreciation Right, Restricted Stock Award, Restricted Stock Unit Award, Deferred Stock Unit Award, Performance Award, Dividend Equivalent Award, Other Stock-Based Award, Performance-Based Cash Awards, or any other right or interest relating to Stock or cash, granted to a Participant under the Plan.

(c) "Award Certificate" means a written document, in such form as the Committee prescribes from time to time, setting forth the terms and conditions of an Award. Award Certificates may be in the form of individual award agreements or certificates or a program document describing the terms and provisions of an Award or series of Awards under the Plan.

(d) "Board" means the Board of Directors of the Company.

(e) "Cause" as a reason for a Participant's termination of employment shall have the meaning assigned such term in the employment, severance or similar agreement, if any, between such Participant and the Company or an Affiliate, provided, however that if there is no such employment, severance or similar agreement in which such term is defined, and unless otherwise defined in the applicable Award Certificate, "Cause" shall mean any of the following acts by the Participant, as determined by the Committee: (i) gross neglect of duty, (ii) prolonged absence from duty without the consent of the Company, (iii) intentionally

engaging in any activity that is in conflict with or adverse to the business, reputation or other interests of the Company, or (iv) willful misconduct, misfeasance or malfeasance of duty which is reasonably determined to be detrimental to the Company. With respect to a Participant's termination of directorship, "Cause" means an act or failure to act that constitutes cause for removal of a director under applicable Delaware law. The determination of the Committee as to the existence of "Cause" shall be conclusive on the Participant and the Company.

(f) "Change in Control" unless otherwise determined by the Committee in the applicable Award Certificate, a "Change in Control" shall be deemed to have occurred upon any of the following events; provided, however, that the Board shall at all times prior to the occurrence of any particular event described in this Section 2.1(f) have the authority to decide, in its sole discretion, that such event shall be deemed not to constitute a "Change in Control" for purposes hereof:

(i) individuals who, on the Effective Date, constitute the Board of Directors of the Company (the "Incumbent Directors") cease for any reason to constitute at least a majority of such Board; provided, however, that any person becoming a director after the Effective Date and whose election or nomination for election was approved by a vote of at least a majority of the Incumbent Directors then on the Board shall be an Incumbent Director; provided, further, that no individual initially elected or nominated as a director of the Company as a result of an actual or threatened election contest with respect to the election or removal of directors ("Election Contest") or other actual or threatened solicitation of proxies or consents by or on behalf of any Person other than the Board ("Proxy Contest"), including by reason of any agreement intended to avoid or settle any Election Contest or Proxy Contest, shall be deemed an Incumbent Director; or

(ii) any Person becomes a "beneficial owner" (as defined in Rule 13d-3 under the 1934 Act), directly or indirectly, of either (A) 40% or more of the then-outstanding shares of common stock of the Company ("Company Common Stock") or (B) securities of the Company representing 40% or more of the combined voting power of the Company's then outstanding securities eligible to vote for the election of directors (the "Company Voting Securities"); provided, however, that for purposes of this subsection (ii), the following acquisitions of Company Common Stock or Company Voting Securities shall not constitute a Change in Control: (w) an acquisition directly from the Company, (x) an acquisition by the Company or a Subsidiary of the Company, (y) an acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any Subsidiary of the Company, or (z) an acquisition pursuant to a Non-Qualifying Transaction (as defined in subsection (iii) below); or

(iii) the consummation of a reorganization, merger, consolidation, statutory share exchange or similar form of corporate transaction involving the Company or a Subsidiary (a "Reorganization"), or the sale or other disposition of all or substantially all of the Company's assets (a "Sale") or the acquisition of assets or stock of another corporation or other entity (an "Acquisition"), unless immediately following such Reorganization, Sale or Acquisition, all or substantially all of the individuals and entities who were the beneficial owners, respectively, of the outstanding Company Common Stock and outstanding Company Voting Securities immediately prior to such Reorganization, Sale or Acquisition beneficially own, directly or indirectly, more than 50% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of the entity resulting from such Reorganization, Sale or Acquisition (including, without limitation, an entity which as a result of such transaction owns the Company or all or substantially all of the Company's assets or stock either direct-

ly or through one or more subsidiaries, the “Surviving Entity”) in substantially the same proportions as their ownership, immediately prior to such Reorganization, Sale or Acquisition, of the outstanding Company Common Stock and the outstanding Company Voting Securities, as the case may be (any Reorganization, Sale or Acquisition which satisfies such criterion shall be deemed to be a “Non-Qualifying Transaction”); or

(iv) approval by the stockholders of the Company of a complete liquidation or dissolution of the Company.

Notwithstanding the foregoing, for any Awards that constitute a nonqualified deferred compensation plan within the meaning of Section 409A(d) of the Code and provide for an accelerated payment in connection with a Change in Control, Change in Control shall have the same meaning as set forth in any regulations, revenue procedure, revenue rulings or other pronouncements issued by the Secretary of the United States Treasury pursuant to Section 409A of the Code, applicable to such plans.

(g) “Code” means the Internal Revenue Code of 1986, as amended from time to time, and includes a reference to the underlying final regulations.

(h) “Committee” means the committee of the Board described in Article 4.

(i) “Company” means Family Dollar Stores, Inc., a Delaware corporation, or any successor corporation.

(j) “Covered Employee” means a “covered employee” as defined in Code Section 162(m)(3).

(k) “Deferred Stock Unit” means a right granted to a Participant under Article 11.

(l) “Director” means any individual who is a member of the Board.

(m) “Disability” or “Disabled” has the same meaning as provided in any long-term disability plan or policy maintained by the Company or if applicable, most recently maintained, by the Company or if applicable, an Affiliate (whether or not the Participant actually participates or receives disability benefits under such plan or policy); provided, however, that in no event shall a Participant be deemed Disabled for purposes of the Plan within the six-month period beginning on the date the Participant commences employment with the Company or an Affiliate. If the determination of Disability relates to an Incentive Stock Option, or a Stock Appreciation Right issued in tandem with an Incentive Stock Option, Disability means “permanent and total disability” as defined in Section 22(e)(3) of the Code. In the event of a dispute, the determination whether a Participant is Disabled will be made by the Committee and may be supported by the advice of a physician competent in the area to which such Disability relates. Notwithstanding the foregoing, for any Awards that constitute a nonqualified deferred compensation plan within the meaning of Section 409A(d) of the Code and provide for an accelerated payment in connection with any Disability, Disability shall have the same meaning as set forth in any regulations, revenue procedure, revenue rulings or other pronouncements issued by the Secretary of the United States Treasury pursuant to Section 409A of the Code, applicable to such plans.

(n) “Dividend Equivalent” means a right granted to a Participant under Article 12.

(o) "Effective Date" has the meaning assigned such term in Section 3.1.

(p) "Eligible Individual" means an employee, officer, consultant or director of the Company or any Affiliate.

(q) "Exchange" means the New York Stock Exchange or any other national securities exchange on which the Stock may from time to time be listed or traded.

(r) "Fair Market Value", on any date, means (i) if the Stock is listed on the New York Stock Exchange or another national securities exchange or is traded over the Nasdaq National Market, the average of the highest price and lowest price at which the Stock is sold regular way on such exchange or over such system on such date or, in the absence of reported sales on such date, on the immediately preceding date on which sales were reported, or (ii) if the Stock is not listed on any securities exchange or traded over the Nasdaq National Market, the mean between the bid and offered prices as quoted by Nasdaq for such date, provided that if it is determined that the fair market value is not properly reflected by such Nasdaq quotations, Fair Market Value will be determined in compliance with Sections 162(m) and 409A of the Code, to the extent applicable, or by such other method as the Committee determines in good faith to be reasonable.

(s) "Good Reason" has the meaning assigned such term in the employment, severance or similar agreement, if any, between a Participant and the Company or an Affiliate, provided, however that if there is no such employment, severance or similar agreement in which such term is defined, and unless otherwise defined in the applicable Award Certificate, "Good Reason" shall mean any of the following acts by the Company or an Affiliate, without the consent of the Participant (in each case, other than an isolated, insubstantial and inadvertent action not taken in bad faith and which is remedied by the Company or the Affiliate promptly after receipt of notice thereof given by the Participant): (i) a reduction by the Company or an Affiliate in the Participant's base salary, (ii) a material reduction in the Participant's position, duties and responsibilities, assignment to duties inconsistent with such position or material adverse change in reporting relationships, (iii) with respect to a Participant who is stationed at the Company's headquarters in Charlotte, North Carolina, or in Matthews, North Carolina, the Company or an Affiliate requiring the Participant, without his or her consent, to be based at any office or location more than 35 miles from the location at which the Participant was stationed immediately prior to a Change in Control, or (iv) the continuing material breach by the Company or an Affiliate of any employment agreement between the Participant and the Company or an Affiliate after the expiration of any applicable period for cure.

(t) "Grant Date" of an Award means the first date on which all necessary corporate action has been taken to approve the grant of the Award as provided in the Plan, or such later date as is determined and specified as part of that authorization process.

(u) "Incentive Stock Option" means an Option that is intended to be an incentive stock option and meets the requirements of Section 422 of the Code or any successor provision thereto.

(v) "Insider" means an individual who is, on the relevant date, an officer, director or ten percent (10%) beneficial owner of any class of the Company's equity securities that is registered pursuant to Section 12 of the 1934 Act, all as defined under Section 16 of the 1934 Act and the rules thereunder.

(w) "Nonstatutory Stock Option" means an Option that is not an Incentive Stock Option.



(x) "Option" means a right granted to a Participant under Article 7 of the Plan to purchase Stock at a specified price during specified time periods. An Option may be either an Incentive Stock Option or a Nonstatutory Stock Option.

(y) "Other Stock-Based Award" means a right, granted to a Participant under Article 13, that relates to or is valued by reference to Stock or other Awards relating to Stock.

(z) "Parent" means a corporation, limited liability company, partnership or other entity which owns or beneficially owns a majority of the outstanding voting stock or voting power of the Company. Notwithstanding the above, with respect to an Incentive Stock Option, Parent shall have the meaning set forth in Section 424(e) of the Code.

(aa) "Participant" means an Eligible Individual who has been granted an Award under the Plan; provided that in the case of the death of a Participant, the term "Participant" refers to a beneficiary designated pursuant to Section 15.5 or the legal guardian or other legal representative acting in a fiduciary capacity on behalf of the Participant under applicable state law.

(bb) "Performance Award" means Performance Shares, Performance Units or Performance-Based Cash Awards granted pursuant to Article 9.

(cc) "Performance-Based Cash Award" means a right granted to a Participant under Article 9 to a cash award to be paid upon achievement of such performance goals as the Committee establishes with regard to such Award.

(dd) "Performance Share" means any right granted to a Participant under Article 9 to a share to be valued by reference to a designated number of Shares to be paid upon achievement of such performance goals as the Committee establishes with regard to such Performance Share.

(ee) "Performance Unit" means a right granted to a Participant under Article 9 to a unit valued by reference to a designated amount of cash or property other than Shares, to be paid to the Participant in cash or in kind upon achievement of such performance goals as the Committee establishes with regard to such Performance Unit.

(ff) "Person" means any individual, entity or group, within the meaning of Section 3(a)(9) of the 1934 Act and as used in Section 13(d)(3) or 14(d)(2) of the 1934 Act.

(gg) "Plan" means this Family Dollar Stores, Inc. 2006 Incentive Plan, as amended or supplemented from time to time.

(hh) "Qualified Performance-Based Award" means, with respect to a Covered Employee, an Award granted to an officer of the Company that is either (i) intended to qualify for the Section 162(m) Exemption and is made subject to performance goals based on Qualified Business Criteria as set forth in Section 14.2, or (ii) an Option or SAR having an exercise price equal to or greater than the Fair Market Value of the underlying Stock as of the Grant Date.

(ii) "Qualified Business Criteria" means one or more of the Business Criteria listed in Section 14.2 upon which performance goals for certain Qualified Performance-Based Awards may be established by the Committee.

(jj) "Restricted Stock Award" means Stock granted to a Participant under Article 10 that is subject to certain restrictions and to risk of forfeiture.

(kk) "Restricted Stock Unit Award" means the right granted to a Participant under Article 10 to receive Shares (or the equivalent value in cash or other property) in the future, which right is subject to certain restrictions and to risk of forfeiture.

(ll) "Retirement" means a Participant's voluntary termination of employment or consultancy at or after having attained age sixty (60) with at least ten (10) years of service with the Company or an Affiliate, or such earlier retirement date as may be approved by the Committee with regard to such Participant. With respect to a Participant's termination of service as a Director, Retirement means the failure to stand for reelection or other retirement as a Director after a Participant has attained age sixty-five (65) or such earlier retirement date as may be approved by the Committee with regard to such Participant.

(mm) "Section 162(m) Exemption" means the exemption from the limitation on deductibility imposed by Section 162(m) of the Code that is set forth in Section 162(m)(4)(C) of the Code or any successor provision thereto.

(nn) "Shares" means shares of the Company's Stock. If there has been an adjustment or substitution pursuant to Section 16.1, the term "Shares" shall also include any shares of stock or other securities that are substituted for Shares or into which Shares are adjusted pursuant to Section 16.1.

(oo) "Stock" means the \$0.10 par value common stock of the Company and such other securities of the Company as may be substituted for Stock pursuant to Article 16.

(pp) "Stock Appreciation Right" or "SAR" means a right granted to a Participant under Article 8 to receive a payment equal to the difference between the Fair Market Value of a Share as of the date of exercise of the SAR over the grant price of the SAR, all as determined pursuant to Article 8.

(qq) "Subsidiary" means any corporation, limited liability company, partnership or other entity of which a majority of the outstanding voting stock or voting power is beneficially owned directly or indirectly by the Company. Notwithstanding the above, with respect to an Incentive Stock Option, Subsidiary shall have the meaning set forth in Section 424(f) of the Code.

(rr) "1933 Act" means the Securities Act of 1933, as amended from time to time.

(ss) "1934 Act" means the Securities Exchange Act of 1934, as amended from time to time.

### ARTICLE 3 EFFECTIVE TERM OF PLAN

3.1. EFFECTIVE DATE. The Plan shall be effective as of the date it is approved by the stockholders of the Company (the "Effective Date"). Upon the Effective Date, no further grants shall be made under the Company's 1989 Non-Qualified Stock Option Plan. No further grants may be made under this Plan after the 10th anniversary of the Effective Date.

**ARTICLE 4**  
**ADMINISTRATION**

4.1. COMMITTEE. The Plan shall be administered by a Committee appointed by the Board (consisting of at least two members) or, at the discretion of the Board from time to time, the Plan may be administered by the Board. Unless otherwise designated by the Board, the Compensation Committee of the Board shall serve as the Committee administering the Plan; provided, however, that (i) with respect to Awards to any Insiders, the Committee shall consist of all of the members of the Compensation Committee who are “non-employee directors” within the meaning of Rule 16b-3 adopted under the 1934 Act, and (ii) with respect to Awards intended to constitute Qualified Performance-Based Awards, the Committee shall consist of all of the members of the Compensation Committee who are “outside directors” within the meaning of Section 162(m) of the Code. For purposes of this Plan, Committee may also mean any individual or committee of individuals (who need not be Directors) that the Compensation Committee may appoint from time to time to administer the Plan with respect to Awards to Eligible Individuals who are not Insiders or Covered Employees, in accordance with and subject to the requirements of Section 4.3. The Board may reserve to itself any or all of the authority and responsibility of the Committee under the Plan or may act as administrator of the Plan for any and all purposes. To the extent the Board has reserved any authority and responsibility or during any time that the Board is acting as administrator of the Plan, it shall have all the powers of the Committee hereunder, and any reference herein to the Committee (other than in this Section 4.1) shall include the Board. To the extent any action of the Board under the Plan conflicts with actions taken by the Committee, the actions of the Board shall control.

4.2. ACTION AND INTERPRETATIONS BY THE COMMITTEE. For purposes of administering the Plan, the Committee may from time to time adopt rules, regulations, guidelines and procedures for carrying out the provisions and purposes of the Plan and make such other determinations, not inconsistent with the Plan, as the Committee may deem appropriate. The Committee’s interpretation of the Plan, any Awards granted under the Plan, any Award Certificate and all decisions and determinations by the Committee with respect to the Plan are final, binding, and conclusive on all parties. Each member of the Committee is entitled to, in good faith, rely or act upon any report or other information furnished to that member by any officer or other employee of the Company or any Affiliate, the Company’s or an Affiliate’s independent certified public accountants, Company counsel or any executive compensation consultant or other professional retained by the Company to assist in the administration of the Plan.

4.3. AUTHORITY OF COMMITTEE. Except as provided below, the Committee has the exclusive power, authority and discretion to:

- (a) Grant Awards;
- (b) Designate Participants;
- (c) Determine the type or types of Awards to be granted to each Participant;
- (d) Determine the number of Awards to be granted and the number of Shares or dollar amount to which an Award will relate;
- (e) Determine the terms and conditions (not inconsistent with the terms of this Plan) of any Award granted under the Plan, including but not limited to, the exercise price, grant price, or purchase price, any restrictions or limitations on the Award, any schedule for lapse of forfeiture restrictions or restrictions on the

exercisability of an Award, and accelerations or waivers thereof, based in each case on such considerations as the Committee in its sole discretion determines;

(f) Determine whether, to what extent, and under what circumstances an Award may be settled in, or the exercise price of an Award may be paid in, cash, Stock, other Awards, or other property, or an Award may be canceled, forfeited, or surrendered;

(g) Prescribe the form of each Award Certificate, which need not be identical for each Participant;

(h) Decide all other matters that must be determined in connection with an Award;

(i) Establish, adopt or revise any rules, regulations, guidelines or procedures as it may deem necessary or advisable to administer the Plan;

(j) Make all other decisions and determinations that may be required under the Plan or as the Committee deems necessary or advisable to administer the Plan;

(k) Amend the Plan or any Award Certificate as provided herein;

(l) Adopt such modifications, procedures, and subplans as may be necessary or desirable to comply with provisions of the laws of non-U.S. jurisdictions in which the Company or any Affiliate may operate, in order to assure the viability of the benefits of Awards granted to participants located in such other jurisdictions and to meet the objectives of the Plan; and

(m) Appoint and compensate agents, counsel, auditors or other specialists to aid it in the discharge of its duties.

Notwithstanding the above, to the extent permitted by applicable law, the Committee may delegate its authority as identified herein to any individual or committee of individuals (who need not be Directors), including without limitation the authority to make Awards to Eligible Individuals who are not Insiders or Covered Employees. To the extent that the Committee delegates its authority to make Awards as provided by this Section 4.3, all references in the Plan to the Committee's authority to make Awards and determinations with respect thereto shall be deemed to include the Committee's delegate. Any such delegate shall serve at the pleasure of, and may be removed at any time by, the Committee.

4.4. AWARD CERTIFICATES. Each Award shall be evidenced by an Award Certificate. Each Award Certificate shall include such provisions, not inconsistent with the Plan, as may be specified by the Committee.

## ARTICLE 5 SHARES SUBJECT TO THE PLAN

5.1. NUMBER OF SHARES. Subject to adjustment as provided in Sections 5.2 and 16.1, the aggregate number of Shares reserved and available for issuance pursuant to Awards granted under the Plan shall be (i) Twelve Million (12,000,000) Shares, plus (ii) any Shares covered by an award made under the Company's 1989 Non-Qualified Stock Option Plan prior to the Effective Date that is canceled, terminates, expires, forfeits or lapses for any reason after the Effective Date.

5.2. SHARE COUNTING.

(a) To the extent that an Award is canceled, terminates, expires, is forfeited or lapses for any reason, any unissued Shares from such Award will again be available for issuance pursuant to Awards granted under the Plan.

(b) Shares subject to Awards settled in cash will again be available for issuance pursuant to Awards granted under the Plan.

(c) Substitute Awards granted pursuant to Section 15.11 of the Plan shall not count against the Shares otherwise available for issuance under the Plan under Section 5.1.

5.3. SOURCE OF SHARES. Any Stock distributed pursuant to an Award may consist, in whole or in part, of authorized and unissued Stock, treasury Stock or Stock purchased on the open market, all as determined by the Chief Financial Officer of the Company (or the Chief Financial Officer's designee) from time to time, unless otherwise determined by the Committee.

5.4. LIMITATIONS ON AWARDS. Notwithstanding any provision in the Plan to the contrary (but subject to adjustment as provided in Section 16.1):

(a) The maximum number of Shares that may be issued upon exercise of Incentive Stock Options granted under the Plan shall be 1,000,000.

(b) The maximum number of Shares with respect to one or more Options, SARs, Restricted Stock, Restricted Stock Units, Deferred Stock Units, Performance Shares or other Stock-Based Awards that may be granted during any one calendar year under the Plan to any one Participant shall be 500,000.

(c) The aggregate dollar value of any Performance-Based Cash Award or other cash-based award that may be paid to any one Participant during any one calendar year under the Plan shall be \$1,000,000.

**ARTICLE 6  
ELIGIBILITY**

6.1 GENERAL. Awards may be granted only to Eligible Individuals, except as limited for Incentive Stock Options under Section 7.2(g).

**ARTICLE 7  
STOCK OPTIONS**

7.1. GENERAL. The Committee is authorized to grant Options to Participants on the following terms and conditions:

(a) EXERCISE PRICE. The exercise price per Share under an Option shall be determined by the Committee; provided, however, that the exercise price of an Option (other than an Option issued as a substitute Award pursuant to Section 15.11) shall not be less than the Fair Market Value as of the Grant Date.

(b) TIME AND CONDITIONS OF EXERCISE. The Committee shall determine the time or times at which an Option may be exercised in whole or in part, subject to Section 7.1(d). The Committee shall also determine the performance or other conditions, if any, that must be satisfied before all or part of an Option may be exercised or vested.

(c) PAYMENT. Options shall be exercised by the delivery of a notice of exercise to the Company, setting forth the number of Shares with respect to which the Option is to be exercised, accompanied by full payment for the Shares. To be effective, notice of exercise must be made in accordance with procedures established by the Company from time to time.

The Option price due upon exercise of any Option shall be payable to the Company in full either: (i) in cash or its equivalent, or (ii) by tendering previously acquired Shares having an aggregate Fair Market Value at the time of exercise equal to the total Option price (provided that the Shares which are tendered must have been held by the Participant for at least six (6) months prior to their tender to satisfy the Option price unless such Shares had been acquired by the Participant on the open market), or (iii) by a combination of (i) and (ii).

As soon as practicable after notification of exercise and full payment, the Company shall deliver the Shares to the Participant in an appropriate amount based upon the number of Shares purchased under the Option(s).

Notwithstanding the foregoing, the Committee also may allow (A) cashless exercises as permitted under Federal Reserve Board's Regulation T, subject to applicable securities law restrictions, or (B) exercises by any other means which the Committee determines to be consistent with the Plan's purpose and applicable law.

(d) EXERCISE TERM. In no event may any Option be exercisable for more than ten years from the Grant Date.

7.2. INCENTIVE STOCK OPTIONS. The terms of any Incentive Stock Options granted under the Plan must comply with the following additional rules:

(a) EXERCISE PRICE. The exercise price of an Incentive Stock Option shall not be less than the Fair Market Value as of the Grant Date.

(b) LAPSE OF OPTION. Subject to any earlier termination provision contained in the Award Certificate, an Incentive Stock Option shall lapse upon the earliest of the following circumstances; provided, however, that the Committee may, prior to the lapse of the Incentive Stock Option under the circumstances described in subsections (3), (4) or (5) below, provide in writing that the Option will extend until a later date, but if an Option is so extended and is exercised after the dates specified in subsections (3) and (4) below, it will automatically become a Nonstatutory Stock Option:

- (1) The expiration date set forth in the Award Certificate.
- (2) The tenth anniversary of the Grant Date.

(3) Three months after termination of the Participant's employment with the Company and its Affiliates for any reason other than the Participant's Disability or death.

(4) One year after termination of the Participant's employment with the Company and its Affiliates by reason of the Participant's Disability.

(5) One year after the Participant's death if the Participant dies while employed, or during the three-month period described in paragraph (3) or during the one-year period described in paragraph (4) and before the Option otherwise lapses.

Unless the exercisability of the Incentive Stock Option is accelerated as provided in Article 15, if a Participant exercises an Option after termination of employment, the Option may be exercised only with respect to the Shares that were otherwise vested on the Participant's termination of employment. Upon the Participant's death, any exercisable Incentive Stock Options may be exercised by the Participant's beneficiary, determined in accordance with Section 15.5.

(c) INDIVIDUAL DOLLAR LIMITATION. The aggregate Fair Market Value (determined as of the Grant Date) of all Shares with respect to which Incentive Stock Options (under all plans maintained by the Company) are first exercisable by a Participant in any calendar year may not exceed \$100,000.00.

(d) TEN PERCENT OWNERS. No Incentive Stock Option shall be granted to any individual who, at the Grant Date, in accordance with Section 424(d) of the Code, owns stock possessing more than ten percent of the total combined voting power of all classes of stock of the Company or any Parent or Subsidiary unless the exercise price per share of such Option is at least 110% of the Fair Market Value per Share at the Grant Date and the Option expires no later than five years after the Grant Date.

(e) EXPIRATION OF AUTHORITY TO GRANT INCENTIVE STOCK OPTIONS. No Incentive Stock Option may be granted pursuant to the Plan after the day immediately prior to the tenth anniversary of the Effective Date of the Plan, or the termination of the Plan, if earlier.

(f) RIGHT TO EXERCISE. During a Participant's lifetime, an Incentive Stock Option may be exercised only by the Participant or, in the case of the Participant's Disability, by the Participant's guardian or legal representative.

(g) ELIGIBLE GRANTEES. The Committee may not grant an Incentive Stock Option to a person who is not at the Grant Date an employee of the Company or a Parent or Subsidiary.

## ARTICLE 8 STOCK APPRECIATION RIGHTS

8.1. GRANT OF STOCK APPRECIATION RIGHTS. The Committee is authorized to grant Stock Appreciation Rights to Participants on the following terms and conditions:

(a) RIGHT TO PAYMENT. Upon the exercise of a Stock Appreciation Right, the Participant to whom it is granted, has the right, to receive upon exercise, at the Committee's election, either a payment in cash or Shares, equal to the excess, if any, of:

(1) The Fair Market Value of one Share on the date of exercise; over

(2) The base value of the Stock Appreciation Right as determined by the Committee, which shall not be less than the Fair Market Value of one Share on the Grant Date (other than an SAR issued as a substitute Award pursuant to Section 15.11 or unless the SAR is granted in tandem with an Option after the Grant Date of the Option, in which case, to the extent permitted under Section 409A of the Code and the regulations promulgated thereunder, the base price of the SAR may equal the exercise price of the related Option even if less than the Fair Market Value of one Share on the Grant Date of the SAR).

(b) OTHER TERMS. The terms, methods of exercise, methods of settlement, form of consideration payable in settlement, and any other terms and conditions of any Stock Appreciation Right shall be determined by the Committee. With respect to a Stock Appreciation Right, the number of shares to be counted against the share pool in Section 5.1 above shall be the number of net shares with respect to which the award is granted.

## **ARTICLE 9 PERFORMANCE AWARDS**

9.1. GRANT OF PERFORMANCE AWARDS. The Committee is authorized to grant Performance Shares, Performance Units or Performance-Based Cash Awards to Participants on such terms and conditions as may be selected by the Committee.

9.2. PERFORMANCE GOALS. The Committee may establish performance goals for Performance Awards which may be based on any criteria selected by the Committee. Such performance goals may be described in terms of Company-wide objectives or in terms of objectives that relate to the performance of the Participant, an Affiliate or a division, region, department or function within the Company or an Affiliate. If the Committee determines that a change in the business, operations, corporate structure or capital structure of the Company or the manner in which the Company or an Affiliate conducts its business, or other events or circumstances render performance goals to be unsuitable, the Committee may modify such performance goals in whole or in part, as the Committee deems appropriate. If a Participant is promoted, demoted or transferred to a different business unit or function during a performance period, the Committee may determine that the performance goals or performance period are no longer appropriate and may (i) adjust, change or eliminate the performance goals or the applicable performance period as it deems appropriate to make such goals and period comparable to the initial goals and period, or (ii) make a cash payment to the participant in an amount determined by the Committee. The foregoing two sentences shall not apply with respect to a Performance Award that is intended to be a Qualified Performance-Based Award, except to the extent the Committee exercises such negative discretion as is permitted under applicable law for purposes of the Section 162(m) Exemption.

9.3. RIGHT TO PAYMENT. The grant of a Performance Share to a Participant will entitle the Participant to receive at a specified later time a specified number of Shares, or the equivalent cash value, if the performance goals established by the Committee are achieved and the other terms and conditions thereof are satisfied. The grant of a Performance Unit to a Participant will entitle the Participant to receive at a specified later



time a specified dollar value, which may be settled in cash or other property, including Shares, variable under conditions specified in the Award, if the performance goals in the Award are achieved and the other terms and conditions thereof are satisfied. The grant of a Performance-Based Cash Award to a Participant will entitle the Participant to receive at a specified later time a specified dollar value in cash variable under conditions specified in the Award, if the performance goals in the Award are achieved and the other terms and conditions thereof are satisfied. The Committee shall set performance goals and other terms or conditions to payment of the Performance Awards in its discretion which, depending on the extent to which they are met, will determine the value of the Performance Awards that will be paid to the Participant.

9.4. OTHER TERMS. The terms, methods of exercise, methods of settlement, form of consideration payable in settlement, and any other terms and conditions of any Performance Awards shall be determined by the Committee. For purposes of determining the number of Shares to be used in payment of a Performance Award denominated in cash but payable in whole or in part in Shares or Restricted Stock, the number of Shares to be so paid will be determined by dividing the cash value of the Award to be so paid by the Fair Market Value of a Share on the date of determination by the Committee of the amount of the payment under the Award, or, if the Committee so directs, the date immediately preceding the date the Award is paid.

## **ARTICLE 10**

### **RESTRICTED STOCK AND RESTRICTED STOCK UNIT AWARDS**

10.1. GRANT OF RESTRICTED STOCK AND RESTRICTED STOCK UNITS. The Committee is authorized to make Awards of Restricted Stock or Restricted Stock Units to Participants in such amounts and subject to such terms and conditions as may be selected by the Committee, subject to Section 5.4.

10.2. ISSUANCE AND RESTRICTIONS. Restricted Stock or Restricted Stock Units shall be subject to such restrictions on transferability and other restrictions as the Committee may impose (including, without limitation, limitations on the right to vote Restricted Stock or the right to receive dividends on the Restricted Stock or dividend equivalents on the Restricted Stock Units) covering a period of time specified by the Committee (the "Restriction Period"). These restrictions may lapse separately or in combination at such times, under such circumstances, in such installments, upon the satisfaction of performance goals or otherwise, as the Committee determines at the time of the grant of the Award or thereafter. Except as otherwise provided in an Award Certificate, the Participant shall have all of the rights of a stockholder with respect to the Restricted Stock, and the Participant shall have none of the rights of a stockholder with respect to Restricted Stock Units until such time as Shares of Stock are paid in settlement of the Restricted Stock Units.

10.3. FORFEITURE. Except as provided in an Award Certificate or otherwise determined by the Committee at the time of the grant of the Award or thereafter, immediately after termination of the Participant's employment or other service relationship with the Company and its Affiliates during the applicable Restriction Period or upon failure to satisfy a performance goal during the applicable Restriction Period, Restricted Stock or Restricted Stock Units that are at that time subject to restrictions shall be forfeited.

10.4. DELIVERY OF RESTRICTED STOCK. Shares of Restricted Stock shall be delivered to the Participant at the time of grant either by book-entry registration or by delivering to the Participant, or a custodian or escrow agent (including, without limitation, the Company or one or more of its employees) designated by the Committee, a stock certificate or certificates registered in the name of the Participant. If physical certificates representing shares of Restricted Stock are registered in the name of the Participant, such certificates must bear an appropriate legend referring to the terms, conditions, and restrictions applicable to such Restricted Stock.

**ARTICLE 11**  
**DEFERRED STOCK UNITS**

11.1. GRANT OF DEFERRED STOCK UNITS. The Committee is authorized to grant Deferred Stock Units to Participants subject to such terms and conditions as may be selected by the Committee. Deferred Stock Units shall entitle the Participant to receive Shares of Stock (or the equivalent value in cash or other property if so determined by the Committee) at a future time as determined by the Committee, or as determined by the Participant within guidelines established by the Committee in the case of voluntary deferral elections.

**ARTICLE 12**  
**DIVIDEND AND INTEREST EQUIVALENTS**

12.1. GRANT OF DIVIDEND EQUIVALENTS. The Committee is authorized to grant Dividend Equivalents to Participants subject to such terms and conditions as may be selected by the Committee. Dividend Equivalents shall entitle the Participant to receive payments equal in value to the cash dividends that would have been paid with respect to all or a portion of the number of Shares subject to any Award, if such Shares had been outstanding, as determined by the Committee. The Committee may provide that Dividend Equivalents be paid or distributed when accrued or be deemed to have been reinvested in additional Shares or units equivalent to Shares, or otherwise reinvested.

12.2 GRANT OF INTEREST EQUIVALENTS. The Committee is authorized to grant Interest Equivalents to Participants subject to such terms and conditions as may be selected by the Committee. Interest Equivalents shall entitle the Participant to receive payments equal to a stated rate of return on the value of an outstanding Award, as determined by the Committee. The Committee may provide that Interest Equivalents be paid or distributed when accrued or be deemed to have been reinvested in additional Shares or units equivalent to Shares, or otherwise reinvested.

**ARTICLE 13**  
**STOCK OR OTHER STOCK-BASED AWARDS**

13.1. GRANT OF STOCK OR OTHER STOCK-BASED AWARDS. The Committee is authorized, subject to limitations under applicable law, to grant to Participants such other Awards that are payable in, valued in whole or in part by reference to, or otherwise based on or related to Shares or other property, as deemed by the Committee to be consistent with the purposes of the Plan, including without limitation Shares awarded purely as a "bonus" and not subject to any restrictions or conditions, convertible or exchangeable debt securities, other rights convertible or exchangeable into Shares, and Awards valued by reference to book value of Shares or the value of securities of or the performance of specified Parents or Affiliates ("Other Stock-Based Awards"). Such Other Stock-Based Awards shall also be available as a form of payment in the settlement of other Awards granted under the Plan. The Committee shall determine the terms and conditions of such Other Stock-Based Awards.

**ARTICLE 14**  
**QUALIFIED PERFORMANCE-BASED AWARDS**

14.1. OPTIONS AND STOCK APPRECIATION RIGHTS. The provisions of the Plan are intended to ensure that all Options and Stock Appreciation Rights granted hereunder to any Covered Employee shall qualify for the Section 162(m) Exemption.

14.2. OTHER AWARDS. When granting an Award other than an Option or a Stock Appreciation Right, the Committee may designate such Award as a Qualified Performance-Based Award, based upon a determination that the recipient is or may be a Covered Employee with respect to such Award, and the Committee wishes such Award to qualify for the Section 162(m) Exemption. If an Award is so designated, the Committee shall establish performance goals for such Award within the time period prescribed by Section 162(m) of the Code based on one or more of the following Qualified Business Criteria, which may be expressed in terms of Company-wide objectives or in terms of objectives that relate to the performance of an Affiliate or a division, region, department, function or combination thereof within the Company or an Affiliate:

- Revenue
- Sales
- Profit (net profit, gross profit, operating profit, economic profit, profit margins or other corporate profit measures)
- Earnings on a pre-tax or post-tax basis (EBIT, EBITDA, earnings per share, earnings growth or other corporate earnings measures)
- Net income (before or after taxes, operating income or other income measures)
- Cash (cash flow, cash generation or other cash measures)
- Stock price or performance
- Total stockholder return (stock price appreciation plus reinvested dividends divided by beginning share price or other measures of return)
- Financial return measures (including, but not limited to, dividends, return on assets, capital, equity, or sales, and cash flow return on assets, capital, equity, or sales);
- Market share measures
- Improvements in capital structure
- Expenses (operating expense, expense management, expense ratio, expense efficiency ratios or other expense measures)
- Business expansion or consolidation (acquisitions and divestitures)
- Internal rate of return or increase in net present value
- Working capital targets relating to inventory and/or accounts receivable
- Planning accuracy (as measured by comparing planned results to actual results)
- Productivity improvement
- Inventory measures (turns, reduction, shrink)
- Customer relations (count, frequency, size of basket, attitude)
- Compliance goals (employee turnover, social goals, diversity goals, safety programs, regulatory or legal compliance)
- Goals relating to business expansion, acquisitions and divestitures.

Performance goals with respect to the foregoing Qualified Business Criteria may be specified in absolute terms, in percentages, or in terms of growth from period to period or growth rates over time, as well as measured relative to an established or specially-created performance index of Company competitors or peers. Any member of a specially-created performance index that undergoes a corporate event or transaction of a kind described in Article 16 or that files a petition for bankruptcy during a measurement period shall be disregarded from and after such event, unless the Committee determines not to disregard such entity or to make some other adjustment to measuring the performance index and the effect of such Committee determination is to reduce the amount payable under any affected Qualified Performance-Based Award. Performance goals need not be based upon an increase or positive result under a business criterion and could include, for example, the maintenance of the status quo or the limitation of economic losses (measured, in each case, by reference to a specific business criterion). Notwithstanding anything herein to the contrary, the Committee may

exercise, with respect to such Qualified Business Criteria and related performance goals, such negative discretion as is permitted under applicable law for purposes of the Section 162(m) Exemption.

14.3. PERFORMANCE GOALS. Each Qualified Performance-Based Award (other than a market-priced Option or SAR) shall be earned, vested and payable (as applicable) only upon the achievement of performance goals established by the Committee based upon one or more of the Qualified Business Criteria, together with the satisfaction of any other conditions, such as continued employment, as the Committee may determine to be appropriate; provided, however, that the Committee may provide, either in connection with the grant thereof or by amendment thereafter, that achievement of such performance goals will be waived upon the death or Disability of the Participant, or upon a Change in Control. Performance periods established by the Committee for any such Qualified Performance-Based Award may be as short as three months and may be any longer period. In addition, the Committee may reserve the right, in connection with the grant of a Qualified Performance-Based Award, to exercise negative discretion to determine that the portion of such Award actually earned, vested and/or payable (as applicable) shall be less than the portion that would be earned, vested and/or payable based solely upon application of the applicable performance goals.

14.4. INCLUSIONS AND EXCLUSIONS FROM PERFORMANCE CRITERIA. The Committee may determine prospectively, at the time that goals under this Article 14 are established, whether or not to adjust any such goals during or after the fiscal year period to take into consideration and/or mitigate the unbudgeted impact of unusual or non-recurring gains and losses, accounting changes, acquisitions, dispositions, divestitures, and/or "extraordinary items" within the meaning of generally accepted accounting principles ("non-recurring items"), or if such non-recurring items were not foreseen or were not quantifiable at the time such goals were established, upon the occurrence of such non-recurring items, including any of the following that occur during a fiscal year period: (a) asset write-downs or impairment charges; (b) litigation or claim costs, judgments or settlements; (c) the effect of changes in tax laws, accounting principles or other laws or provisions affecting reported results; (d) restatements occurring as a result of errors that arise from events other than fraud or failures in performance; (e) accruals for reorganization and restructuring programs; (f) extraordinary nonrecurring items as described in Accounting Principles Board Opinion No. 30 and/or in management's discussion and analysis of financial condition and results of operations appearing in the Company's annual report to stockholders for the applicable year; (g) acquisitions or divestitures; and (h) foreign exchange gains and losses.

14.5. CERTIFICATION OF PERFORMANCE GOALS. Any payment of a Qualified Performance-Based Award granted with performance goals pursuant to Section 14.3 above shall be conditioned on the written certification of the Committee in each case that the performance goals and any other material conditions were satisfied. Except as specifically provided in Section 14.3, no Qualified Performance-Based Award held by a Covered Employee or by an employee who in the reasonable judgment of the Committee may be a Covered Employee on the date of payment, may be amended, nor may the Committee exercise any discretionary authority it may otherwise have under the Plan with respect to a Qualified Performance-Based Award under the Plan, in any manner to waive the achievement of the applicable performance goal based on Qualified Business Criteria or to increase the amount payable pursuant thereto or the value thereof, or otherwise in a manner that would cause the Qualified Performance-Based Award to cease to qualify for the Section 162(m) Exemption.

## **ARTICLE 15**

### **PROVISIONS APPLICABLE TO AWARDS**

15.1. STAND-ALONE AND TANDEM AWARDS. Awards granted under the Plan may, in the discretion of the Committee, be granted either alone or in addition to, in tandem with, any other Award granted under the

Plan. Subject to Section 17.2, Awards granted in addition to or in tandem with other Awards may be granted either at the same time as or at a different time from the grant of such other Awards.

15.2. TERM OF AWARD. The term of each Award shall be for the period as determined by the Committee, provided that in no event shall the term of any Option or a Stock Appreciation Right exceed a period of ten years from its Grant Date (or, if Section 7.2(d) applies, five years from its Grant Date).

15.3. FORM OF PAYMENT FOR AWARDS. Subject to the terms of the Plan and any applicable law (including, but not limited Section 409A of the Code and the regulations promulgated thereunder) or Award Certificate, payments or transfers to be made by the Company or an Affiliate on the grant or exercise of an Award may be made in such form as the Committee determines at or after the Grant Date, including without limitation, cash, Stock, other Awards, or other property, or any combination, and may be made in a single payment or transfer, in installments, or on a deferred basis, in each case determined in accordance with rules adopted by, and at the discretion of, the Committee.

15.4. LIMITS ON TRANSFER. No right or interest of a Participant in any unexercised or restricted Award may be pledged, encumbered, or hypothecated to or in favor of any party other than the Company or an Affiliate, or shall be subject to any lien, obligation, or liability of such Participant to any other party other than the Company or an Affiliate. No unexercised or restricted Award shall be assignable or transferable by a Participant other than by will or the laws of descent and distribution; provided, however, that the Committee may (but need not) permit other transfers where the Committee concludes that such transferability (i) does not result in accelerated taxation, (ii) does not cause any Option intended to be an Incentive Stock Option to fail to be described in Code Section 422(b), and (iii) is otherwise appropriate and desirable, taking into account any factors deemed relevant, including without limitation, state or federal tax or securities laws applicable to transferable Awards. Any purported transfer in violation of this Section 15.4 shall be null and void.

15.5. BENEFICIARIES. Notwithstanding Section 15.4, a Participant may, in the manner determined by the Committee, designate a beneficiary to exercise the rights of the Participant and to receive any distribution with respect to any Award upon the Participant's death. A beneficiary, legal guardian, legal representative, or other person claiming any rights under the Plan is subject to all terms and conditions of the Plan and any Award Certificate applicable to the Participant, except to the extent the Plan and Award Certificate otherwise provide, and to any additional restrictions deemed necessary or appropriate by the Committee. If no beneficiary has been designated or survives the Participant, payment shall be made to the Participant's surviving spouse or, in the absence of a surviving spouse, to the Participant's estate. Subject to the foregoing, a beneficiary designation may be changed or revoked by a Participant at any time provided the change or revocation is filed with the Company.

15.6. STOCK CERTIFICATES. All Stock issuable under the Plan is subject to any stop-transfer orders and other restrictions as the Committee deems necessary or advisable to comply with federal or state securities laws, rules and regulations and the rules of any national securities exchange or automated quotation system on which the Stock is listed, quoted, or traded. The Committee may place legends on any Stock certificate or issue instructions to the transfer agent to reference restrictions applicable to the Stock.

15.7. EFFECT OF A CHANGE IN CONTROL. The provisions of this Section 15.7 shall apply in the case of a Change in Control, unless otherwise provided in the Award Certificate or any special Plan document or separate agreement with a Participant governing an Award.

(a) Awards not Assumed or Substituted by Surviving Entity. Upon the occurrence of a Change in

Control, and except with respect to any Awards assumed by the Surviving Entity or otherwise equitably converted or substituted in connection with the Change in Control in a manner approved by the Committee or the Board: (i) outstanding Options, SARs, and other Awards in the nature of rights that may be exercised shall become fully exercisable and shall remain exercisable for their full term, (ii) time-based vesting restrictions on outstanding Awards shall lapse, and (iii) the target payout opportunities attainable under outstanding performance-based Awards shall be deemed to have been fully earned as of the effective date of the Change in Control based upon the greater of: (A) an assumed achievement of all relevant performance goals at the “target” level, or (B) the actual level of achievement of all relevant performance goals against target as of the Company’s fiscal quarter end preceding the Change in Control, and, in either such case, there shall be a prorata payout to Participants within thirty (30) days following the Change in Control based upon the length of time within the performance period that has elapsed prior to the Change in Control. Any Awards shall thereafter continue or lapse in accordance with the other provisions of the Plan and the Award Certificate. To the extent that this provision causes Incentive Stock Options to exceed the dollar limitation set forth in Section 7.2(b), the excess Options shall be deemed to be Nonstatutory Stock Options.

(b) Awards Assumed or Substituted by Surviving Entity. With respect to Awards assumed by the Surviving Entity or otherwise equitably converted or substituted in connection with a Change in Control, unless the Award Certificate expressly provides otherwise: if within two years after the effective date of the Change in Control, a Participant’s employment is terminated without Cause or the Participant resigns for Good Reason, then (i) all of that Participant’s outstanding Options, SARs and other Awards in the nature of rights that may be exercised shall become fully exercisable and shall remain exercisable for their full term, (ii) all time-based vesting restrictions on outstanding Awards shall lapse, and (iii) the target payout opportunities attainable under all of that Participant’s outstanding performance-based Awards shall be deemed to have been fully earned as of the date of termination based upon the great of: (A) an assumed achievement of all relevant performance goals at the “target” level, or (B) the actual level of achievement of all relevant performance goals against target as of the Company’s fiscal quarter end preceding the Change in Control, and, in either such case, there shall be a prorata payout to such Participant within thirty (30) days following the date of termination of employment based upon the length of time within the performance period that has elapsed prior to the date of termination of employment. Any Awards shall thereafter continue or lapse in accordance with the other provisions of the Plan and the Award Certificate. To the extent that this provision causes Incentive Stock Options to exceed the dollar limitation set forth in Section 7.2(b), the excess Options shall be deemed to be Nonstatutory Stock Options.

(c) For purposes of Section 15.7 (a) and (b), “target” shall mean the amount of the performance-based Award initially granted to a Participant as a “target” amount to be awarded subject to adjustment pursuant to the terms and conditions of the Award.

15.8. DISCRETIONARY ACCELERATION. Regardless of whether an event has occurred as described in Section 15.7 above, and subject to Article 14 as to Qualified Performance-Based Awards, the Committee may in its sole discretion at any time determine that, upon the termination of service of a Participant, or the occurrence of a Change in Control, all or a portion of such Participant’s Options, SARs and other Awards in the nature of rights that may be exercised shall become fully or partially exercisable, that all or a part of the restrictions on all or a portion of the Participant’s outstanding Awards shall lapse, and/or that any performance-based criteria with respect to any Awards held by that Participant shall be deemed to be wholly or partially satisfied, in each case, as of such date as the Committee may, in its sole discretion, declare. The Committee may discriminate among Participants and among Awards granted to a Participant in exercising its discretion pursuant to this Section 15.8.

15.9. TERMINATION OF EMPLOYMENT. The Committee shall be entitled to make such rules, regulations, and determinations as it deems appropriate under this Plan in respect of any leave of absence taken by an employee or any other change in employment status, such as a change from full time employment to a consulting relationship, of an employee relative to an Award. Without limiting the foregoing, the Committee shall be entitled to determine (i) whether or not any such leave of absence or other change in employment status, including the receipt of continuing payments provided pursuant to a written severance or employment agreement, shall constitute a termination of employment within the meaning of this Plan and (ii) the impact, if any, of any such leave of absence or other change in employment status on Awards under this Plan made to any employee who takes such leave of absence or otherwise changes his or her employment status. To the extent that this provision causes Incentive Stock Options to extend beyond three months from the date a Participant is deemed to cease to be an employee of the Company, a Parent or Subsidiary for purposes of Sections 424(e) and 424(f) of the Code, the Options held by such Participant shall be deemed to be Nonstatutory Stock Options.

15.10. FORFEITURE EVENTS. The Committee may specify in an Award Certificate that the Participant's rights, payments and benefits with respect to an Award shall be subject to reduction, cancellation, forfeiture or recoupment upon the occurrence of certain specified events. Such events may include, but are not limited to, termination of employment for Cause, violation of material Company or Affiliate policies, breach of non-competition, confidentiality or other restrictive covenants that may apply to the Participant, or other conduct by the Participant that is detrimental to the business or reputation of the Company or any Affiliate.

15.11. SUBSTITUTE AWARDS. The Committee may grant Awards under the Plan in substitution for stock and stock-based awards held by employees of another entity who become employees of the Company or an Affiliate as a result of a merger or consolidation of the former employing entity with the Company or an Affiliate or the acquisition by the Company or an Affiliate of property or stock of the former employing corporation. The Committee may direct that the substitute awards be granted on such terms and conditions as the Committee considers appropriate in the circumstances.

## **ARTICLE 16 CHANGES IN CAPITAL STRUCTURE**

16.1. GENERAL. In the event of a corporate event or transaction involving the Company (including, without limitation, any stock dividend, stock split, extraordinary cash dividend, recapitalization, reorganization, merger, consolidation, split-up, spin-off, combination or exchange of shares), the authorization limits under Section 5.1 and 5.4 shall be adjusted proportionately, and the Committee may adjust the Plan and Awards to preserve the benefits or potential benefits of the Awards. Action by the Committee may include: (i) adjustment of the number and kind of shares which may be delivered under the Plan; (ii) adjustment of the number and kind of shares subject to outstanding Awards; (iii) adjustment of the exercise price of outstanding Awards or the measure to be used to determine the amount of the benefit payable on an Award; and (iv) any other adjustments that the Committee determines to be equitable. In addition, upon the occurrence or in anticipation of such an event, the Committee may, in its sole discretion, provide (i) that Awards will be settled in cash rather than Stock, (ii) that Awards will become immediately vested and exercisable and will expire after a designated period of time to the extent not then exercised, (iii) that Awards will be assumed by another party to a transaction or otherwise be equitably converted or substituted in connection with such transaction, (iv) that outstanding Awards may be settled by payment in cash or cash equivalents equal to the excess of the Fair Market Value of the underlying Stock, as of a specified date associated with the transaction, over the exercise price of the Award, (v) that performance targets and performance periods for Performance Awards will be modified, consistent with Code Section 162(m) where applicable, or (vi) any combination of the foregoing. The Committee's determination need not be uniform and

may be different for different Participants whether or not such Participants are similarly situated. Without limiting the foregoing, in the event of a subdivision of the outstanding Stock (stock-split), a declaration of a dividend payable in Shares, or a combination or consolidation of the outstanding Stock into a lesser number of Shares, the authorization limits under Section 5.1 and 5.4 shall automatically be adjusted proportionately, and the Shares then subject to each Award shall automatically be adjusted proportionately without any change in the aggregate purchase price therefore. To the extent that any adjustments made pursuant to this Article 15 cause Incentive Stock Options to cease to qualify as Incentive Stock Options, such Options shall be deemed to be Nonstatutory Stock Options.

## ARTICLE 17 AMENDMENT, MODIFICATION AND TERMINATION

### 17.1. AMENDMENT, MODIFICATION AND TERMINATION.

(a) The Board or the Committee may, at any time and from time to time, amend, modify or terminate the Plan without stockholder approval; provided, however, that if an amendment to the Plan would, in the reasonable opinion of the Board or the Committee, either (i) materially increase the number of Shares available under the Plan, (ii) expand the types of awards under the Plan, (iii) materially expand the class of participants eligible to participate in the Plan, (iv) materially extend the term of the Plan, or (v) otherwise constitute a material change requiring stockholder approval under applicable laws or the applicable listing or other requirements of an Exchange, then such amendment shall be subject to stockholder approval; and provided, further, that the Board or Committee may condition any amendment or modification on the approval of stockholders of the Company for any reason, including by reason of such approval being necessary or deemed advisable to (i) to comply with the listing or other requirements of an Exchange, or (ii) to satisfy any other tax, securities or other applicable laws, policies or regulations.

(b) No termination, amendment, or modification of the Plan shall adversely affect any Award previously granted under the Plan, without the written consent of the Participant affected thereby. An outstanding Award shall not be deemed to be "adversely affected" by a Plan amendment if such amendment would not reduce or diminish the value of such Award determined as if the Award had been exercised, vested, cashed in or otherwise settled on the date of such amendment (with the per-share value of an Option or Stock Appreciation Right for this purpose being calculated as the excess, if any, of the Fair Market Value as of the date of such amendment over the exercise price or base value of such Award).

(c) Notwithstanding the foregoing, the Company reserves the right to amend the Plan or any Award granted under the Plan, by action of the Board or the Committee, without the consent of any affected Participant, to the extent deemed necessary or appropriate for purposes of maintaining compliance with Section 409A of the Code and the regulations promulgated thereunder.

17.2. AWARDS PREVIOUSLY GRANTED. At any time and from time to time, the Committee may amend, modify or terminate any outstanding Award without approval of the Participant; provided, however:

(a) Subject to the terms of the applicable Award Certificate, such amendment, modification or termination shall not, without the Participant's consent, reduce or diminish the value of such Award determined as if the Award had been exercised, vested, cashed in or otherwise settled on the date of such amendment or termination (with the per-share value of an Option or Stock Appreciation Right for this purpose being cal-



culated as the excess, if any, of the Fair Market Value as of the date of such amendment or termination over the exercise or base price of such Award);

(b) The original term of an Option may not be extended without the prior approval of the stockholders of the Company; and

(c) Except as otherwise provided in Article 16, the exercise price of an Option may not be reduced, directly or indirectly, without the prior approval of the stockholders of the Company.

## **ARTICLE 18 GENERAL PROVISIONS**

18.1. NO RIGHTS TO AWARDS; NON-UNIFORM DETERMINATIONS. No Participant or any Eligible Individual shall have any claim to be granted any Award under the Plan. Neither the Company, its Affiliates nor the Committee is obligated to treat Participants or Eligible Individuals uniformly, and determinations made under the Plan may be made by the Committee selectively among Eligible Individuals who receive, or are eligible to receive, Awards (whether or not such Eligible Individuals are similarly situated).

18.2. NO STOCKHOLDER RIGHTS. No Award gives a Participant any of the rights of a stockholder of the Company unless and until Shares are in fact issued to such Participant in connection with the Award.

18.3. WITHHOLDING. The Company or any Affiliate shall have the authority and the right to deduct or withhold, or require a Participant to remit to the Company, an amount sufficient to satisfy federal, state, and local taxes (including the Participant's FICA obligation) required by law to be withheld with respect to any exercise, lapse of restriction or other taxable event arising as a result of the Plan or an Award. If Shares are permitted to be surrendered to the Company to satisfy tax obligations in excess of the minimum tax withholding obligation, such Shares must have been held by the Participant as fully vested shares for such period of time, if any, as necessary to avoid the recognition of an expense under generally accepted accounting principles. The Company shall have the authority to require a Participant to remit cash to the Company in lieu of the surrender of Shares for tax withholding obligations if the surrender of Shares in satisfaction of such withholding obligations would result in the Company's recognition of expense under generally accepted accounting principles. With respect to withholding required upon any taxable event under the Plan, the Committee may, at the time the Award is granted or thereafter, require or permit that any such withholding requirement be satisfied, in whole or in part, by withholding from the Award Shares having a Fair Market Value on the date of withholding equal to the minimum amount (and not any greater amount) required to be withheld for tax purposes.

18.4. NO RIGHT TO CONTINUED SERVICE. Nothing in the Plan, any Award Certificate or any other document or statement made with respect to the Plan, shall interfere with or limit in any way the right of the Company or any Affiliate to terminate any Participant's employment or status as an officer, director or consultant at any time, nor confer upon any Participant any right to continue as an employee, officer, director or consultant of the Company or any Affiliate, whether for the duration of a Participant's Award or otherwise.

18.5. UNFUNDED STATUS OF AWARDS. The Plan is intended to be an "unfunded" plan for incentive and deferred compensation. With respect to any payments not yet made to a Participant pursuant to an Award, nothing contained in the Plan or any Award Certificate shall give the Participant any rights that are greater than those of a general creditor of the Company or any Affiliate. This Plan is not intended to be subject to ERISA.

18.6. RELATIONSHIP TO OTHER BENEFITS. No payment under the Plan shall be taken into account in determining any benefits under any pension, retirement, savings, profit sharing, group insurance, welfare or benefit plan of the Company or any Affiliate unless specifically provided otherwise in such other plan.

18.7. TITLES AND HEADINGS. The titles and headings of the Sections in the Plan are for convenience of reference only, and in the event of any conflict, the text of the Plan, rather than such titles or headings, shall control.

18.8. GENDER AND NUMBER. Except where otherwise indicated by the context, any masculine term used herein also shall include the feminine; the plural shall include the singular and the singular shall include the plural.

18.9. FRACTIONAL SHARES. No fractional Shares shall be issued and the Committee shall determine, in its discretion, whether cash shall be given in lieu of fractional Shares or whether such fractional Shares shall be eliminated by rounding up or down.

18.10. GOVERNMENT AND OTHER REGULATIONS.

(a) Notwithstanding any other provision of the Plan, no Participant who acquires Shares pursuant to the Plan may, during any period of time that such Participant is an affiliate of the Company (within the meaning of the rules and regulations of the Securities and Exchange Commission under the 1933 Act), sell such Shares, unless such offer and sale is made (i) pursuant to an effective registration statement under the 1933 Act, which is current and includes the Shares to be sold, or (ii) pursuant to an appropriate exemption from the registration requirement of the 1933 Act, such as that set forth in Rule 144 promulgated under the 1933 Act.

(b) Notwithstanding any other provision of the Plan, if at any time the Committee shall determine that the registration, listing or qualification of the Shares covered by an Award upon any Exchange or under any foreign, federal, state or local law or practice, or the consent or approval of any governmental regulatory body, is necessary or desirable as a condition of, or in connection with, the granting of such Award or the purchase or receipt of Shares thereunder, no Shares may be purchased, delivered or received pursuant to such Award unless and until such registration, listing, qualification, consent or approval shall have been effected or obtained free of any condition not acceptable to the Committee. Any Participant receiving or purchasing Shares pursuant to an Award shall make such representations and agreements and furnish such information as the Committee may request to assure compliance with the foregoing or any other applicable legal requirements. The Company shall not be required to issue or deliver any certificate or certificates for Shares under the Plan prior to the Committee's determination that all related requirements have been fulfilled. The Company shall in no event be obligated to register any securities pursuant to the 1933 Act or applicable state or foreign law or to take any other action in order to cause the issuance and delivery of such certificates to comply with any such law, regulation or requirement.

18.11. GOVERNING LAW. To the extent not governed by federal law, the Plan and all Award Certificates shall be construed in accordance with and governed by the laws of the State of Delaware.

18.12. ADDITIONAL PROVISIONS. Each Award Certificate may contain such other terms and conditions as the Committee may determine; provided that such other terms and conditions are not inconsistent with the provisions of the Plan.

18.13. NO LIMITATIONS ON RIGHTS OF COMPANY. The grant of any Award shall not in any way affect the right or power of the Company to make adjustments, reclassification or changes in its capital or business structure or to merge, consolidate, dissolve, liquidate, sell or transfer all or any part of its business or assets. The Plan shall not restrict the authority of the Company, for proper corporate purposes, to draft or assume awards, other than under the Plan, to or with respect to any person. If the Committee so directs, the Company may issue or transfer Shares to an Affiliate, for such lawful consideration as the Committee may specify, upon the condition or understanding that the Affiliate will transfer such Shares to a Participant in accordance with the terms of an Award granted to such Participant and specified by the Committee pursuant to the provisions of the Plan.

18.14. INDEMNIFICATION. Each person who is or shall have been a member of the Committee, or of the Board, or an officer of the Company to whom authority was delegated in accordance with Article 4 shall be indemnified and held harmless by the Company against and from any loss, cost, liability, or expense that may be imposed upon or reasonably incurred by him or her in connection with or resulting from any claim, action, suit, or proceeding to which he or she may be a party or in which he or she may be involved by reason of any action taken or failure to act under the Plan and against and from any and all amounts paid by him or her in settlement thereof, with the Company's approval, or paid by him or her in satisfaction of any judgment in any such action, suit, or proceeding against him or her, provided he or she shall give the Company an opportunity, at its own expense, to handle and defend the same before he or she undertakes to handle and defend it on his or her own behalf, unless such loss, cost, liability, or expense is a result of his or her own willful misconduct or except as expressly provided by statute. The foregoing right of indemnification shall not be exclusive of any other rights of indemnification to which such persons may be entitled under the Company's charter or bylaws, as a matter of law, or otherwise, or any power that the Company may have to indemnify them or hold them harmless.

18.15. FOREIGN PARTICIPANTS. In order to facilitate the granting of Awards to Eligible Individuals who are foreign nationals or who are employed outside of the United States of America, the Committee may provide for such special terms and conditions, including without limitation substitutes for Awards, as the Committee may consider necessary or appropriate to accommodate differences in local law, tax policy or custom. The Committee may approve any supplements to, or amendments, restatements or alternative versions of this Plan as it may consider necessary or appropriate for the purposes of this Section 18.16 without thereby affecting the terms of this Plan as in effect for any other purpose, and the Secretary or other appropriate officer of the Company may certify any such documents as having been approved and adopted pursuant to properly delegated authority; provided, that no such supplements, amendments, restatements or alternative versions shall include any provisions that are inconsistent with the spirit of this Plan, as then in effect. Participants subject to the laws of a foreign jurisdiction may request copies of, or the right to view, any materials that are required to be provided by the Company pursuant to the laws of such jurisdiction.

18.16. NOTICE. Except as otherwise provided in this Plan, any notice which either the Company or a Participant may be required or permitted to give shall be in writing and may be delivered personally, by intraoffice mail, by fax, by electronic mail or other electronic means, or via a postal service, postage prepaid, to such electronic mail or postal address and directed to such person as the Company may notify Participants from time to time; and to the Participant at the Participant's electronic mail or postal address as shown on the records of the Company from time to time, or at such other electronic mail or postal address as the Participant, by notice to the Company, may designate in writing from time to time.

18.17. INUREMENT OF RIGHTS AND OBLIGATIONS. The rights and obligations under this Plan and any related documents shall inure to the benefit of, and shall be binding upon, the Company, its successors and assigns, and the Participants and their beneficiaries.

18.18. COSTS AND EXPENSES. Except as otherwise provided herein, the costs and expenses of administering this Plan shall be borne by the Company, and shall not be charged to any Award or to any Participant receiving an Award. Costs and expenses associated with the redemption or exercise of any Award under this Plan, including, but not limited to, commissions charged by any agent of the Company, may be charged to the Participant.

18.19. COMPLIANCE WITH CODE SECTION 409A. The Plan is intended to comply with Code Section 409A. Notwithstanding any provision of the Plan to the contrary, the Plan shall be interpreted, operated and administered consistent with this intent.

18.20. ARBITRATION. All claims, disputes and controversies arising out of or in any way related to this Plan or any Award hereunder, including any claim, dispute or controversy relating to the validity or enforceability of this Plan or any Award, shall be resolved by binding arbitration administered by the American Arbitration Association pursuant to the Commercial Arbitration Rules of the American Arbitration Association in effect as of the time that the dispute, claim or controversy is submitted for resolution. Arbitration hearings shall be held in Charlotte, North Carolina, and judgment upon any award may be entered by any court having jurisdiction. The costs of arbitration, including the fees and expenses of the arbitrator, shall be shared equally by the parties unless otherwise required by law or directed by the arbitrator in his or her award. Each party shall be responsible for paying its or his own attorneys' fees unless the arbitrator orders otherwise in compliance with governing law. All aspects of the arbitration process, including the demand for arbitration, the hearing, and the record of the proceeding, are confidential and shall not be open to or disclosed to any third party or the public, unless required by law, including judicial or administrative process, or in connection with a regulatory inquiry, investigation or proceeding.

(This page intentionally left blank)

(This page intentionally left blank)



P.O. BOX 1017
CHARLOTTE, NC 28201

VOTE BY INTERNET - www.proxyvote.com

Use the Internet to transmit your voting instructions and for electronic delivery of information up until 11:59 P.M. Eastern Time the day before the meeting date.

ELECTRONIC DELIVERY OF FUTURE SHAREHOLDER COMMUNICATIONS

If you would like to reduce the costs incurred by Family Dollar Stores, Inc. in mailing proxy materials, you can consent to receiving all future proxy statements, proxy cards and annual reports electronically via e-mail or the Internet.

VOTE BY PHONE - 1-800-690-6903

Use any touch-tone telephone to transmit your voting instructions up until 11:59 P.M. Eastern Time the day before the meeting date.

VOTE BY MAIL

Mark, sign and date your proxy card and return it in the postage-paid envelope we have provided or return it to Family Dollar Stores, Inc., c/o ADP, 51 Mercedes Way, Edgewood, NY 11717.

TO VOTE, MARK BLOCKS BELOW IN BLUE OR BLACK INK AS FOLLOWS:

FMLYD1

KEEP THIS PORTION FOR YOUR RECORDS

THIS PROXY CARD IS VALID ONLY WHEN SIGNED AND DATED.

DETACH AND RETURN THIS PORTION ONLY

FAMILY DOLLAR STORES, INC.

Vote on Directors

1. ELECTION OF DIRECTORS

Nominees:

- 01) Mark R. Bernstein
02) Sharon Allred Decker
03) Edward C. Dolby
04) Glenn A. Eisenberg
05) Howard R. Levine
06) George R. Mahoney, Jr.
07) James G. Martin

For All Withhold For All Except

Input boxes for For All, Withhold, For All Except

(INSTRUCTION: To withhold authority to vote for any individual nominee, mark "For All Except" and print that nominee's name below.)

\_\_\_\_\_

Vote on Proposals

2. Approval of Family Dollar Stores, Inc. 2006 Incentive Plan:

For Against Abstain

Input boxes for For, Against, Abstain

3. Ratification of the appointment of PricewaterhouseCoopers LLP as Independent Registered Public Accountants:

Input boxes for For, Against, Abstain

4. In their discretion, upon such other business as may properly come before the meeting or any adjournments thereof.

This Proxy is revocable, and the undersigned retains the right to attend this meeting and to vote his or her stock in person. The undersigned hereby acknowledges receipt of the Notice of Annual Meeting of Shareholders and Proxy Statement.

(Please sign exactly as your name appears at right. If there is more than one owner, each should sign. When signing as a fiduciary or representative, please give full title as such. If the signer is a corporation, please sign full corporate name by duly authorized officer. If a partnership, please sign in partnership name by authorized person.)

Yes No

HOUSEHOLDING ELECTION - Please indicate if you consent to receive certain future investor communications in a single package per household.

Input boxes for Yes, No

Signature box

Signature [PLEASE SIGN WITHIN BOX] Date

Signature box

Signature (Joint Owners) Date

**HOUSEHOLDING** - The Securities and Exchange Commission has enacted a rule that allows multiple investors residing at the same address the convenience of receiving a single copy of annual reports, proxy statements, prospectuses and other disclosure documents if they consent to do so. We will allow Householdings only upon certain conditions. Some of those conditions are:

- You agree to or do not object to the Householdings of your materials,
- You have the same last name and exact address as another investor(s)

The HOUSEHOLDING ELECTION which appears on the attached proxy card, provides a means for you to notify us whether or not you consent to participate in Householdings. By marking "Yes" in the block provided, you consent to participate in Householdings. By marking "No" you withhold your consent to participate. If you do *nothing* you will be deemed to have given your consent to participate, and Householdings will start 60 days after the mailing of this notice. Your consent to Householdings will be perpetual unless you withhold or revoke it. You may revoke your consent at any time by contacting ADP-ICS, either by calling toll-free at (800) 542-1061, or by writing to ADP-ICS, Householdings Department, 51 Mercedes Way, Edgewood, New York, 11717. We will remove you from the Householdings program within 30 days of receipt of your response, following which you will receive an individual copy of all disclosure documents.

---

**FAMILY DOLLAR** 

**PROXY**

**FAMILY DOLLAR STORES, INC.**

**Proxy for Annual Meeting of Shareholders on January 19, 2006**

**THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS**

The undersigned hereby appoints Howard R. Levine and R. James Kelly, or either one of them, with full power of substitution, proxies of the undersigned to the Annual Meeting of Shareholders of Family Dollar Stores, Inc. to be held at 2:00 p.m. on Thursday, January 19, 2006, at the office of the Company at 10401 Monroe Road, Matthews, North Carolina, or at any adjournments thereof, with all the powers which the undersigned would possess if personally present, and instructs them to vote upon any matter which may properly be acted upon at this meeting, and specifically as indicated on the reverse side.

This Proxy, if received and correctly signed, will be voted in accordance with the choices specified. **If a choice is not specified, this Proxy will be voted in favor of the election of the Directors named, for the approval of Family Dollar Stores, Inc. 2006 Incentive Plan and for the ratification of the appointment of the Independent Registered Public Accountants.**

**(Please Sign on Reverse Side)**

**PLEASE SIGN AND RETURN PROXY PROMPTLY IN THE ACCOMPANYING ENVELOPE. NO POSTAGE IS REQUIRED.**



**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

**Annual Report Pursuant to Section 13 or 15(d) of  
the Securities Exchange Act of 1934**

For the fiscal year ended August 27, 2005

or

**Transition Report Pursuant to Section 13 or 15(d) of  
the Securities Exchange Act of 1934**

Commission File No. 1-6807

**FAMILY DOLLAR STORES, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**56-0942963**

(I.R.S. Employer Identification No.)

**10401 Monroe Road, Matthews, North Carolina**

(Address of principal executive offices)

**28105**

(Zip Code)

**P. O. Box 1017, Charlotte, North Carolina 28201-1017**

(Mailing address)

Registrant's telephone number, including area code

(704) 847-6961

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

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Common Stock, \$.10 Par Value	New York Stock Exchange

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

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes  No

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

The aggregate market value of voting and non-voting common equity held by non-affiliates of the registrant on February 26, 2005, based on the closing price on February 25, 2005, was approximately \$5.1 billion.

The number of shares of the registrant's Common Stock outstanding as of October 17, 2005, was 155,264,313.

DOCUMENTS INCORPORATED BY REFERENCE

The information required in Part III of this Form 10-K is incorporated by reference to the registrant's definitive proxy statement to be filed for the Annual Meeting of Stockholders to be held on January 19, 2006.

## PART I

*This report contains "forward-looking statements" that are based on the current expectations of Family Dollar Stores, Inc. Actual results in future periods may differ materially from those expressed or implied by those forward-looking statements because of a number of factors set forth in this Annual Report on Form 10-K ("Report"). Statements that are forward-looking may be identified by the use of the words "plan," "estimate," "expect," "anticipate," "probably," "should," "project," "intend," "continue," and similar terms and expressions. For a discussion of the factors that may affect the Company's future business and prospects, see Management's Discussion and Analysis ("MD&A") - Cautionary Statement Regarding Forward-Looking Statements.*

*Information is provided herein with respect to the Company's operations related to the Company's fiscal years ended on August 27, 2005 ("fiscal 2005"); on August 28, 2004 ("fiscal 2004"); on August 30, 2003 ("fiscal 2003"); on August 31, 2002 ("fiscal 2002"); and on September 1, 2001 ("fiscal 2001"); and the fiscal year ending on August 26, 2006 ("fiscal 2006").*

### ITEM 1. BUSINESS

#### General

Family Dollar Stores, Inc., (together with its wholly-owned subsidiaries and entities referred to herein as the "Company") operates a chain of almost 6,000 retail discount stores in a 44-state area, providing primarily low to lower-middle income consumers with a wide range of general merchandise at highly competitive prices in convenient neighborhood stores. The goods offered by the Company generally have price points that range from under one dollar to ten dollars and include apparel, food, cleaning and paper products, home decor, beauty and health aids, toys, pet products, automotive products, domestics and seasonal goods.

The original predecessor of the Company was organized in 1959 to operate a self-service retail store in Charlotte, North Carolina. In subsequent years, additional stores were opened, and separate corporations generally were organized to operate these stores. Family Dollar Stores, Inc., was incorporated in Delaware in 1969, and all then-existing corporate entities became its wholly-owned subsidiaries.

#### Overview of Business Operations

The Company owns or leases and operates all of its retail discount stores located in 44 states of the United States. The Company's stores are operated on a self-service basis, and low overhead permits the sale of merchandise at a relatively moderate markup. As discussed below, the Company's merchandise consists of a variety of hardline and softline merchandise. The Company's stores are located in urban, suburban, small town and rural markets. See Properties herein. The Company's relatively small store size allows the Company to select store locations that provide neighborhood convenience to its customers in each of these areas. The Company generally prices merchandise uniformly in all of its stores, but some merchandise may carry higher prices in stores in less competitive markets where operating costs are higher. Most items available for sale are priced under ten dollars.

The Company's "everyday low price" strategy relies on offering consistently low prices on its products and utilizing limited advertising and promotional activity. The Company traditionally advertises through circulars available in stores or, occasionally, circulars which are inserted in newspapers or mailed directly to consumers' residences. In the years immediately prior to and during fiscal 2004, the Company distributed one circular in each December period to boost holiday sales. In fiscal 2005, the Company distributed circulars in November and December 2004; and, in April and August 2005. The Company continues to utilize circulars that are passed out in stores monthly, and limited advertising is used to support the opening of new stores.

The Company accepts cash, checks and, in most stores, PIN-based debit cards but does not currently accept credit cards. The Company is currently testing systems that will allow it to accept a broad range of electronic benefits, including food stamps.

As discussed in MD&A elsewhere in this Report, the Company focused on four primary initiatives during fiscal 2005: (i) the installation of refrigerated coolers; (ii) the "Treasure Hunt" merchandise program; (iii) new store openings; and (iv) the Urban Initiative.

No single store accounted for more than one-quarter of one percent of sales during fiscal 2005. The Company's stores are open at least six days a week, with most open on Sundays.

## **Merchandise**

The Company's stores offer a variety of hardline and softline merchandise. Hardline merchandise includes household chemical and paper products, candy, snacks and other food, health and beauty aids, electronics, housewares and giftware, pet food and supplies, toys, stationery and school supplies, seasonal goods, hardware and automotive supplies. Softline merchandise includes men's, women's, boys', girls' and infants' clothing, shoes, and domestic items such as blankets, sheets and towels. During fiscal 2005, hardline merchandise accounted for approximately 78.8% of the Company's sales. Softline merchandise accounted for approximately 21.2% of sales.

During fiscal 2005, nationally advertised brand name merchandise accounted for approximately 37% of sales versus 36% in fiscal 2004. Family Dollar private label merchandise accounted for approximately 4% of sales, and merchandise sold under other labels, or which was unlabeled, accounted for the balance of sales. During fiscal 2005, irregular merchandise accounted for less than one-half of 1% of sales, and closeout merchandise accounted for less than 2% of sales.

For a number of years, the Company has added more hardline consumable merchandise, including nationally recognized brand name merchandise, to its merchandise assortments while reducing the amount of space allocated to apparel and shoes. During fiscal 2005, the Company continued to adjust the merchandise selection in stores, including the introduction of an expanded assortment of hardline consumable merchandise, such as paper products, household chemicals and food. However, approximately the same amount of space was allocated to hardline merchandise and softline merchandise as at the end of fiscal 2004, except in a limited number of stores in which all or most hanging apparel and shoes were removed from the merchandise assortment.

During fiscal 2005, the Company implemented adjustments to its merchandising strategy by increasing levels of opportunistically purchased goods supplementing the basic assortment of merchandise. This "Treasure Hunt" merchandise is designed to create more excitement in stores and attract customers throughout the year, with particular emphasis on the holiday seasons. In fiscal 2006, the Company expects to continue to develop this merchandising strategy.

During fiscal 2005, the Company expanded its food assortment to include perishable foods by installing refrigerated coolers in approximately 1,000 stores. In fiscal 2006, the Company plans to install coolers in approximately 2,500 additional stores.

The Company purchases merchandise from approximately 1,500 suppliers and generally has not experienced difficulty in obtaining adequate quantities of merchandise. Approximately 60% of the merchandise is manufactured in the U.S., and substantially all such merchandise is purchased directly from the manufacturer. Purchases of imported merchandise are made directly from the manufacturer or from importers, and the Company's vendor arrangements provide for payment for such merchandise in U.S. Dollars. No single supplier accounted for more than 8% of the merchandise sold by the Company in fiscal 2005.

The Company maintains a substantial variety and depth of basic and seasonal merchandise inventory in stock in its stores (and in its distribution centers for weekly store replenishment) to attract customers and meet their shopping needs. Vendors' trade payment terms are negotiated to help finance the cost of carrying this inventory. The Company must balance the value of maintaining high inventory levels to meet customers' demands with the potential cost of having inventories at levels that exceed such demands and that may need to be marked down in price in order to sell.

## **Distribution and Logistics**

During fiscal 2005, approximately 4.7% of the merchandise purchased by the Company was shipped directly to stores by the manufacturer or importer. The balance of the merchandise was received at one of the Company's eight distribution centers described below. Merchandise is delivered to stores from the Company's distribution centers by Company-owned trucks and by common and contract carriers. During fiscal 2005, approximately 85% of the merchandise delivered was by common or contract carriers. At the end of fiscal 2005, the average distance between the distribution centers and the stores served by each facility was:

<b>Distribution Center</b>	<b>Number of Stores Served</b>	<b>Average Distance (Miles)</b>
Matthews, NC	775	173
West Memphis, AR	704	260
Front Royal, VA	848	306
Duncan, OK	772	306
Morehead, KY	800	241
Maquoketa, IA	744	310
Odessa, TX	657	566
Marianna, FL	598	267
<b>Totals</b>	<b>5,898</b>	<b>300</b>

During fiscal 2005, the Company also acquired a 90-acre site in Rome, New York, on which the Company is currently constructing its ninth distribution center, which is expected to be operational during the third quarter of fiscal 2006.

### **Technology**

The Company has an integrated system to improve inventory management through merchandise planning and inventory control departments. The inventory management system maintains by-item inventories at all stores and supports a demand forecasting system for replenishment of distribution centers. The Company also utilizes software for automatic store replenishment of basic merchandise and for forecasting-based allocation of non-basic merchandise. These systems give the Company improved tools to facilitate optimum merchandise in-stock positions in stores, reduce markdowns and improve inventory turnover.

During fiscal 2003, the Company began implementation of a new transportation management system designed to improve visibility and cost control for both import and domestic freight movement. The import and domestic inbound portions of this project have been completed.

During fiscal 2004, as part of the Company's "store of the future" multi-year initiative, a new hiring system was designed to provide consistent pre-employment assessments and interviews for prospective employees and was tested in a major urban market. Currently, the new hiring system is utilized in approximately 1,200 stores. The Company also has begun implementing plans to upgrade the stores' communications infrastructure to facilitate communications and provide more interactive training for store employees.

### **Competition**

The business in which the Company is engaged is highly competitive. The principal competitive factors include store locations, price and quality of merchandise, in-stock consistency, merchandise assortment and presentation, and customer service. The Company competes for sales and store locations in varying degrees with international, national, regional and local retailing establishments, including discount stores, department stores, variety stores, dollar stores, discount clothing stores, drug stores, grocery stores, convenience stores, outlet stores, warehouse stores and other stores. Many of the nation's other large retailers have stores in areas in which the Company operates. The relatively small size of the Company's stores permits it to open new stores in rural areas, small towns and in large urban markets, in locations convenient to the Company's low and lower-middle income customer base. The Company's stores offer customers a reasonable selection of competitively priced, basic merchandise within a relatively narrow range of price points.

### **Seasonality**

The Company's sales are slightly seasonal. Historically, sales have been highest in the second fiscal quarter (December, January, and February), representing approximately 27% of total annual sales.

### **Trademarks**

The Company has registered with the U.S. Patent and Trademark Office the name "Family Dollar Stores" as a service mark and also has registered a number of other names as trademarks for certain merchandise sold in stores.

## Employees

As of October 1, 2005, the Company had approximately 24,000 full-time employees and approximately 18,000 part-time employees. None of the Company's employees are covered by collective bargaining agreements. The Company considers its employee relations generally to be good.

## Available Information

The mailing address of the Company's Executive Offices is P.O. Box 1017, Charlotte, North Carolina 28201-1017, and the telephone number at that location is 704-847-6961. The Company's Internet Website is [www.familydollar.com](http://www.familydollar.com). Through a link on the Investors section of the Website, the Company makes available the following filings as soon as reasonably practicable after they are electronically filed with or furnished to the Securities and Exchange Commission: Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to these reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934. These reports and amendments also are available at the Website of the Securities and Exchange Commission at [www.sec.gov](http://www.sec.gov). All such filings are available free of charge.

## ITEM 2. PROPERTIES

The Company operates a chain of self-service retail discount stores. As of October 1, 2005, there were 5,908 stores in 44 states and the District of Columbia as follows:

Texas	739	Massachusetts	87
Ohio	371	New Mexico	86
Florida	319	Maryland	86
North Carolina	309	Colorado	82
Michigan	306	Minnesota	63
Georgia	289	New Jersey	61
New York	258	Utah	52
Pennsylvania	227	Connecticut	50
Louisiana	211	Maine	39
Virginia	203	Iowa	36
Illinois	202	Kansas	34
Tennessee	192	Nebraska	26
Kentucky	179	Delaware	22
South Carolina	175	Idaho	22
Indiana	172	New Hampshire	20
Alabama	144	Rhode Island	20
Wisconsin	133	Nevada	19
Arizona	120	Vermont	9
Oklahoma	112	Wyoming	9
West Virginia	110	South Dakota	7
Mississippi	109	North Dakota	6
Arkansas	98	District of Columbia	5
Missouri	89		

The stores listed above include approximately 41 stores temporarily closed, including stores closed due to Hurricane Katrina and Hurricane Rita, which struck the U.S. Gulf Coast in August 2005 and September 2005, respectively. See MD&A and Note 13 to the Consolidated Financial Statements included in this Report for more information about the impact of these storms.

The number of stores operated by the Company at the end of each of its last five fiscal years is as follows: 5,898 stores for fiscal 2005; 5,466 stores for fiscal 2004; 5,027 stores for fiscal 2003; 4,616 stores for fiscal 2002; and 4,141 stores for fiscal 2001.

During fiscal 2005, 500 stores were opened, 68 stores were closed, 16 stores were relocated within the same shopping center or market area, 33 stores were expanded in size, and 105 stores were renovated. During fiscal 2006, the Company plans to open approximately 400 stores, close approximately 65 stores, and relocate, expand or renovate approximately 75 stores. Such plans are continually reviewed and subject to change. From August 27, 2005, through October 1, 2005, the Company opened 12 new stores, closed 2 stores, and relocated, expanded or renovated 6 stores.

As of October 1, 2005, the Company had in the aggregate approximately 49.9 million square feet of total store space (including receiving rooms and other non-selling areas) and approximately 41.4 million square feet of selling space. The typical store has approximately 7,500 to 9,500 square feet of total area.

The Company's stores are located in large urban, suburban and rural areas, and they are typically freestanding or located in shopping centers with adequate parking available. At the end of fiscal 2005, approximately 20% of the Company's stores were located in large urban markets (markets with populations above 200,000), and approximately 26% of the Company's stores were located in small urban markets (markets with populations greater than 75,000 but less than 200,000) or suburban areas. During fiscal 2005, approximately 35% of new store locations were opened in large urban markets and 28% of new locations were opened in small urban or suburban markets.

With the exception of 481 stores owned by the Company, all of the Company's stores are leased. Most of the leases are for initial terms of five years and for fixed rentals. A large majority of the leases contain provisions that may require additional payments based upon a percentage of sales, property taxes, insurance premiums or common area maintenance charges.

Of the Company's 5,427 leased stores at October 1, 2005, all but 396 leases grant the Company options to renew for additional terms; in most cases for a number of successive five-year periods. The following table sets forth certain data, as of October 1, 2005, concerning the expiration dates of all leases with renewal options:

<u>Fiscal Years</u>	<u>Approximate Number of Leases Expiring Assuming No Exercise of Renewal Options</u>	<u>Approximate Number of Leases Expiring Assuming Full Exercise of Renewal Options</u>
2006	149	0
2007-2009	2,435	10
2010-2012	1,756	106
2013-2015	647	426
2016 and thereafter	44	4,489

Of the 481 Company-owned stores, 127 are located in Texas, with no more than 30 located in any other state. In these owned stores, there are approximately 4.0 million total square feet of space.

The Company also owns its corporate headquarters and distribution center located on a 108-acre tract of land in Matthews, North Carolina, just outside of Charlotte, in two buildings containing approximately 1.13 million square feet. Approximately 890,000 square feet are used for the distribution center which includes receiving, warehousing, shipping and storage facilities. Approximately 240,000 square feet are used for the corporate headquarters.

The Company also owns seven additional full-service distribution centers described in the table below:

<u>Distribution Center</u>	<u>Facility Size</u>		<u>Date Operational</u>
	<u>Land</u>	<u>Building</u>	
West Memphis, AR	75 acres	550,000 sq. ft. 300,000 sq. ft. addition	April 1994 August 1996
Front Royal, VA	75 acres	907,000 sq. ft.	January 1998
Duncan, OK	85 acres	907,000 sq. ft.	July 1999
Morehead, KY	94 acres	907,000 sq. ft.	June 2000
Maquoketa, IA	74 acres	907,000 sq. ft.	March 2002
Odessa, TX	89 acres	907,000 sq. ft.	July 2003
Marianna, FL	76 acres	907,000 sq. ft.	January 2005

In the summer of 2005, the Company began construction of a ninth full-service distribution center on a 90-acre tract of land owned by the Company in Rome, New York. The building will contain approximately 907,000 square feet and is expected to be operational during the third quarter of fiscal 2006.

**ITEM 3. LEGAL PROCEEDINGS**

On January 30, 2001, Janice Morgan and Barbara Richardson, two individuals who have held the position of Store Manager for subsidiaries of the Company, filed a Complaint against the Company in the United States District Court for the Northern District of Alabama. Thereafter, pursuant to the Court's ruling, notice of the pendency of the lawsuit was sent to approximately 13,000 current and former Store Managers holding the position on or after July 1, 1999. Approximately 2,550 of those receiving such notice filed consent forms and joined the lawsuit as plaintiffs, including approximately 2,300 former Store Managers and approximately 250 then current employees. After rulings by the Court on motions to dismiss certain plaintiffs filed by the Company and motions to reconsider filed by plaintiffs, 1,424 plaintiffs remained in the case at the commencement of trial.

The case has proceeded as a collective action under the Fair Labor Standards Act ("FLSA"). The Complaint alleges that the Company violated the FLSA by classifying the named plaintiffs and other similarly situated current and former Store Managers as "exempt" employees who are not entitled to overtime compensation. Plaintiffs seek to recover unpaid overtime compensation in an amount currently estimated to be up to approximately \$50 million, liquidated damages equal to the overtime award, if any, plus an award of attorneys' fees, costs and expenses, and such other relief as the Court may deem proper.

A jury trial in this case commenced on June 13, 2005, in Tuscaloosa, Alabama, and ended on June 28, 2005, with the judge declaring a mistrial after the jury was unable to reach a unanimous decision in the matter. The case is scheduled to be retried commencing on February 21, 2006.

In general, the Company continues to believe that the Store Managers are "exempt" employees under the FLSA and have been properly compensated and that the Company has meritorious defenses that should enable it ultimately to prevail. However, the outcome of any litigation is inherently uncertain. Resolution of this matter could have a material adverse effect on the Company's financial position, liquidity or results of operation.

The Company is involved in numerous other legal proceedings and claims incidental to its business, including litigation related to alleged failures to comply with various state and federal employment laws. While the ultimate outcome cannot be determined, the Company currently believes that these proceedings and claims, both individually and in the aggregate, should not have a material adverse effect on the Company's financial position, liquidity or results of operations. However, the outcome of any litigation is inherently uncertain and, if decided adversely to the Company, the Company may be subject to liability that could have a material adverse effect on the Company's financial position, liquidity or results of operations.

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

There were no matters submitted to a vote of security holders through the solicitation of proxies or otherwise during the fourth quarter of fiscal 2005.

**ITEM 4A. EXECUTIVE OFFICERS OF THE REGISTRANT**

The following information is furnished with respect to each of the executive officers of the Company as of October 1, 2005:

<u>Name</u>	<u>Position and Office</u>	<u>Age</u>
Howard R. Levine <sup>(1)</sup>	Chairman of the Board and Chief Executive Officer	46
R. James Kelly <sup>(2)</sup>	Vice Chairman and Chief Financial and Administrative Officer	58
Robert George <sup>(3)</sup>	Executive Vice President- Merchandising	43
Charles S. Gibson, Jr. <sup>(4)</sup>	Executive Vice President- Supply Chain	44
Dorlisa K. Flur <sup>(5)</sup>	Senior Vice President- Strategy and Business Development	40
Janet G. Kelley <sup>(6)</sup>	Senior Vice President- General Counsel and Secretary	52
C. Martin Sowers <sup>(7)</sup>	Senior Vice President- Finance	47
Barry Sullivan <sup>(8)</sup>	Senior Vice President- Store Operations	41

<sup>(1)</sup> Mr. Howard R. Levine was employed by the Company in various capacities in the Merchandising Department from 1981 to 1987, including employment as Senior Vice President-Merchandising and Advertising. From 1988 to 1992, Mr. Levine was President of Best Price Clothing Stores, Inc., a chain of ladies' apparel stores. From 1992 to April 1996, he was self-employed as an investment manager. He rejoined the Company in April 1996, and was elected Vice President-General Merchandise Manager: Softlines in April 1996, Senior Vice President-Merchandising and Advertising in September 1996, President and Chief Operating Officer in April 1997, Chief Executive Officer in August 1998, and Chairman of the Board in January 2003. He is the son of Leon Levine, the founder and Chairman Emeritus of the Company.

<sup>(2)</sup> Mr. R. James Kelly was employed by the Company as Vice Chairman-Chief Financial and Administrative Officer in January 1997.

<sup>(3)</sup> Mr. Robert George was employed by the Company as Executive Vice President-Merchandising in August 2005. Prior to his employment by the Company, he was employed by Staples Corporation, an office supply retailer, from 1986 to July 2005, where his last position was Senior Vice President, General Merchandise Manager – Office Products.

<sup>(4)</sup> Mr. Charles S. Gibson, Jr., was employed by the Company as Vice President-Logistics in September 1997 and was promoted to Senior Vice President-Distribution and Logistics in October 1999 and to Executive Vice President-Supply Chain in September 2003.

<sup>(5)</sup> Ms. Dorlisa K. Flur was employed by the Company as Senior Vice President-Strategy and Business Development in June 2004. Prior to her employment by the Company, she was employed by McKinsey & Company, a global management consulting firm, from 1988 to May 2004, where her last position was Principal with responsibility for McKinsey's Retail Practice in the Southeast.

<sup>(6)</sup> Ms. Janet G. Kelley was employed by the Company as Senior Vice President-Senior Counsel in January 2004 and promoted to Senior Vice President-General Counsel in May 2005. Prior to her employment by the Company, she was employed by Kmart Corporation, a chain of discount stores, from April 2001 to January 2003, where her last position was Executive Vice President and General Counsel. Kmart Corporation filed a petition for reorganization under Chapter 11 of the Federal bankruptcy laws in January 2002 and



emerged from bankruptcy in May 2003. From June 1999 to April 2001, she was employed by Limited Brands, Inc., a chain of specialty apparel and personal beauty stores, as Vice President and Senior Counsel.

- (7) Mr. C. Martin Sowers was employed by the Company as an accountant in October 1984 and was promoted to Assistant Controller in January 1985. He was elected Controller in January 1986, Vice President-Controller in July 1989 and Senior Vice President-Finance in December 1991.
- (8) Mr. Barry Sullivan was employed by the Company as Vice President-Store Operations in September 2002 and was promoted to Senior Vice President-Store Operations in May 2005. Prior to his employment with the Company, he was employed by Eckerd Corporation, a regional drug store chain, from 1986 to 2002, where his last position was Vice President-Store Operations.

All executive officers of the Company are elected annually by and serve at the pleasure of the Board of Directors until their successors are duly elected.

## PART II

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

The Company's Common Stock is traded on the New York Stock Exchange under the ticker symbol FDO. At October 17, 2005, there were approximately 2,300 holders of record of the Common Stock. The accompanying tables give the high and low sales prices of the Common Stock and the dividends declared per share for each quarter of fiscal 2005 and 2004.

#### Market Prices and Dividends

<u>2005</u>	<u>High</u>	<u>Low</u>	<u>Dividend</u>
First Quarter	\$ 32.30	\$ 25.54	\$ .08 1/2
Second Quarter	35.25	28.25	.09 1/2
Third Quarter	33.64	23.68	.09 1/2
Fourth Quarter	27.15	20.10	.09 1/2
<u>2004</u>	<u>High</u>	<u>Low</u>	<u>Dividend</u>
First Quarter	\$ 44.13	\$ 38.10	\$ .07 1/2
Second Quarter	39.66	32.00	.08 1/2
Third Quarter	38.73	26.51	.08 1/2
Fourth Quarter	34.00	25.09	.08 1/2

The following table sets forth information with respect to purchases of shares of the Company's Common Stock made during the quarter ended August 27, 2005, by or on behalf of the Company or any "affiliated purchaser" as defined by Rule 10b-18(a)(3) of the Securities Exchange Act of 1934.

<u>Period</u>	<u>Total Number of Shares Purchased</u>	<u>Average Price Paid per Share</u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</u>	<u>Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs</u>
June (5/29/05-7/2/05)	446,400	\$ 25.76	446,400	3,883,200
July (7/3/05-7/30/05)	—	—	—	3,883,200
August (7/31/05-8/27/05)	—	—	—	18,705,334 <sup>(1)</sup>
Total	446,400	\$ 25.76	446,400	18,705,334

<sup>(1)</sup> Includes \$300 million of the Company's Common Stock converted to shares using the Company's closing stock price of \$20.24 as of August 26, 2005, which may be acquired pursuant to a repurchase program approved by the Board of Directors on August 18, 2005. See below for additional information.

During fiscal 2004 and fiscal 2003, the Company purchased in the open market 5.6 million and 2.2 million shares of its Common Stock, respectively, at a cost of \$176.7 million and \$65.9 million, respectively. On April 13, 2005, the Company announced that the Board of Directors authorized the purchase of up to an additional 5 million shares of the Company's Common Stock from time to time as market conditions warrant. On August 19, 2005, the Company announced that the Board of Directors authorized the purchase of an additional \$300 million of the Company's Common Stock from time to time as market conditions warrant. During fiscal 2005, the Company purchased in the open market 3.3 million shares of the Company's Common Stock at a cost of \$92.0 million. As of the end of fiscal 2005, the Company had approximately 18.7 million shares authorized to be purchased. There is no expiration date governing the period during which the Company can make share repurchases pursuant to the above referenced authorizations. There are no other repurchase programs under which the Company is authorized to repurchase outstanding shares. Shares purchased prior to the end of fiscal 2005 under the share repurchase authorization are held in treasury or have been reissued under the Family Dollar 2000 Outside Directors Plan.

On September 27, 2005, the Company obtained \$250 million in aggregate proceeds through a private placement under Section 4(2) of the Securities Act of 1933, as amended, of unsecured Senior Notes (the "Notes") to a group of institutional accredited investors. On October 4, 2005, the Company executed an overnight share repurchase transaction with a bank for the acquisition of 10 million shares, or approximately 6%, of the Company's outstanding Common Stock for an initial purchase price of \$19.97 per share pursuant to the \$300 million repurchase authorization. The transaction was financed with the proceeds of the Notes. Shares that are repurchased with the proceeds of the Notes will be canceled and returned to the status of authorized but unissued shares. See Note 13 to the Consolidated Financial Statements included in this Report for more information on the Notes and the overnight share repurchase transaction.

## ITEM 6. SELECTED FINANCIAL DATA

### SUMMARY OF SELECTED FINANCIAL DATA

<u>Years Ended (in thousands, except per share amounts and store data)</u>	<u>August 27, 2005</u>	<u>August 28, 2004</u>	<u>August 30, 2003</u>	<u>August 31, 2002</u>	<u>September 1, 2001</u>
Net sales	\$ 5,824,808	\$ 5,281,888	\$ 4,750,171	\$ 4,162,652	\$ 3,665,362
Cost of sales and operating expenses	5,482,013	4,875,226	4,367,027	3,827,582	3,372,094
Income before income taxes	342,795	406,662	383,144	335,070	293,268
Income taxes	125,286	148,758	139,835	122,288	107,025
Net income	217,509	257,904	243,309	212,782	186,243
Diluted earnings per common share	\$ 1.30	\$ 1.50	\$ 1.40	\$ 1.22	\$ 1.08
Dividends declared	\$ 61,538	\$ 56,077	\$ 49,890	\$ 44,106	\$ 40,352
Dividends declared per common share	\$ 0.37	\$ 0.33	\$ 0.29	\$ .25 1/2	\$ .23 1/2
Total assets	\$ 2,409,501	\$ 2,224,361	\$ 2,065,392	\$ 1,818,541	\$ 1,467,866
Working capital	\$ 460,157	\$ 489,727	\$ 541,913	\$ 507,945	\$ 404,087
Shareholders' equity	\$ 1,428,066	\$ 1,337,082	\$ 1,292,432	\$ 1,140,577	\$ 948,791
Stores opened	500	500	475	525	502
Stores closed	(68)	(61)	(64)	(50)	(50)
Number of stores - end of year	5,898	5,466	5,027	4,616	4,141

The Company did not have any long-term debt at the end of each of its last five fiscal years. On September 27, 2005, the Company obtained \$250 million in aggregate proceeds through the private placement of the Notes to a group of institutional accredited investors. See Note 13 to the Consolidated Financial Statements included in this Report for more information on the Notes.

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

This discussion summarizes the significant factors affecting the consolidated results of operations and financial condition of the Company for fiscal 2005, fiscal 2004 and fiscal 2003. This discussion should be read in conjunction with, and is qualified by, the Consolidated Financial Statements and Notes to Consolidated Financial Statements included in this Report.

### **Fiscal 2005 Overview and Fiscal 2006 Outlook**

During fiscal 2005, the Company began the implementation of four key initiatives designed to increase sales and profitability: the installation of refrigerated coolers in selected stores; the introduction of a "Treasure Hunt" merchandise program; the continuation of an aggressive store opening program; and the Urban Initiative. During fiscal 2006, the Company will continue these initiatives as discussed below.

- Coolers – The installation of refrigerated coolers for the sale of perishable food began in the second quarter of fiscal 2005. The customer traffic generated by coolers increased sales of food and other merchandise throughout the store. At the end of fiscal 2005, refrigerated coolers were installed in approximately 1,000 stores. The Company plans to have refrigerated coolers installed in approximately 2,500 additional stores by the end of fiscal 2006. In addition, the Company is testing new point-of-sale software in a limited number of stores to facilitate the acceptance of food stamps in stores with refrigerated coolers.
- "Treasure Hunt" merchandise program – During fiscal 2005, the Company began supplementing its basic assortment of merchandise with additional opportunistically purchased goods designed to create more excitement in stores throughout the year, with particular emphasis on holiday, spring and back-to-school seasons. The Company will enhance this initiative in fiscal 2006.
- New Stores – During fiscal 2005, the Company opened 500 stores and closed 68 stores. In order to build processes that will support a more balanced distribution of store openings throughout the year, the Company plans to open approximately 400 stores and close approximately 65 stores in fiscal 2006.
- Urban Initiative – The Urban Initiative is designed to improve the operating performance of high sales volume stores in large metropolitan markets through investments in people, process changes and technology, including organizational changes to support a more mobile and flexible workforce. During fiscal 2005, the Urban Initiative was implemented in approximately 1,200 stores. While the Urban Initiative stores have experienced mid-single-digit sales growth and continue to be profitable, the Company's profitability goals have not yet been achieved. For fiscal 2006, the Company will continue its investments in the current "Urban Initiative markets" (approximately 1,300 stores) but does not expect to expand the initiative into new markets until processes have been refined to generate improved results.

The Company currently expects net income per diluted share of Common Stock to be between \$1.30 and \$1.39 for fiscal 2006, compared to \$1.30 in fiscal 2005. The net income per diluted share of Common Stock guidance for fiscal 2006 includes the impact of the expensing of stock options as required by Statement of Financial Accounting Standards ("SFAS") No. 123R, "Share-Based Payment," and other new compensation programs, and also includes the accretive benefit of the Company's share repurchase program and related debt placement. See the Recent Accounting Pronouncements contained in this MD&A for more information on the impact of SFAS No. 123R and the Liquidity and Capital Resources section for more information on the Company's share repurchase program and issuance of the Notes.

Subsequent to the Company's fiscal 2005 year end, Hurricane Katrina and Hurricane Rita struck the U.S. Gulf Coast, impacting numerous stores in the afflicted areas. The Company has property insurance that covers most of its property damage. Since the Company's stores are widely dispersed, lost sales due to closed stores are generally limited and are often offset by increased sales in other stores. Therefore, these storms have not had a material impact in the aggregate on the Company's financial position, liquidity or results of operations. The long-term impact of these storms is more difficult to forecast. The potential increase in energy costs over the long-term could negatively impact the Company and its customers. However, the resources received by customers from government and private organizations and the funds contributed in the rebuilding effort could positively impact sales. Therefore, the Company has not included any impact from these storms in its fiscal 2006 outlook.

### **Net Sales**

Net sales increased approximately 10.3% (\$542.9 million) in fiscal 2005 compared with fiscal 2004, and approximately 11.2% (\$531.7 million) in fiscal 2004 compared with fiscal 2003. The increases in fiscal 2005 and in fiscal 2004 were attributable, in part, to increased sales in comparable stores (stores open more than 13 months) of 2.3% (\$117.1 million) and 1.9% (\$86.3 million), respectively, with the balance of the increases primarily relating to sales from new stores

opened as part of the Company's store growth program. The Urban Initiative, the installation of refrigerated coolers and the "Treasure Hunt" merchandise program all had positive impacts on sales in fiscal 2005. Sales of lower-margin basic consumables continued to be stronger than sales of higher-margin discretionary goods during fiscal 2005, reflecting the difficult economic environment, including higher energy prices, faced by the Company's low and lower-middle income customer base.

The 2.3% increase in comparable store sales during fiscal 2005 includes an increase of approximately 3.7% in the sales of hardline merchandise and a decrease of approximately 2.6% in the sales of softline merchandise. In fiscal 2005, the customer count, as measured by the number of register transactions in comparable stores, decreased approximately 0.7%, and the average transaction increased approximately 2.9% to \$9.22. Increased sales of hardline merchandise have been the primary contributor to the overall sales increases. Hardline merchandise, as a percentage of net sales, increased to approximately 78.8% in fiscal 2005 compared to approximately 77.7% in fiscal 2004. Softline merchandise, as a percentage of net sales, decreased to approximately 21.2% in fiscal 2005 compared to approximately 22.3% in fiscal 2004. The Company distributed four advertising circulars in fiscal 2005 and one advertising circular in fiscal 2004. The circulars are designed to stimulate traffic and inform customers about the Company's "Treasure Hunt" merchandise, seasonal values and competitive prices on core consumables. During fiscal 2006, the Company expects to distribute four advertising circulars.

The 1.9% increase in comparable store sales during fiscal 2004 as compared with fiscal 2003 includes an increase of approximately 3.2% in the sales of hardline merchandise and a decrease of approximately 2.5% in the sales of softline merchandise. Sales of consumable merchandise were stronger than sales of more discretionary merchandise. In fiscal 2004, the customer count increased approximately 0.7%, and the average transaction increased approximately 0.9% to \$8.95. The Company distributed one advertising circular in both fiscal 2004 and fiscal 2003.

Hardline merchandise includes household chemical and paper products, candy, snacks and other food, health and beauty aids, electronics, housewares and giftware, pet food and supplies, toys, stationery and school supplies, seasonal goods, hardware and automotive supplies. Softline merchandise includes men's, women's, boys', girls' and infants' clothing, shoes, and domestic items such as blankets, sheets and towels.

During fiscal 2006, the Company expects comparable store sales to increase 2% to 4% as a result of the ongoing rollout of refrigerated coolers, the impact from "Treasure Hunt" merchandise sales and the operational improvements resulting from the Urban Initiative program.

During fiscal 2005, the Company opened 500 stores and closed 68 stores for a net addition of 432 stores, compared with the opening of 500 stores and closing of 61 stores for a net addition of 439 stores during fiscal 2004. The Company also expanded or relocated 49 stores in fiscal 2005, compared with 79 stores that were expanded or relocated in fiscal 2004. In addition, approximately 105 stores in fiscal 2005 and 116 stores in fiscal 2004 were renovated. In order to build processes that will support a more balanced distribution of store openings throughout the year, the Company plans to open approximately 400 stores and close approximately 65 stores in fiscal 2006. The Company also plans to relocate, expand, or renovate approximately 75 stores during fiscal 2006. Store opening, closing, expansion, relocation and renovation plans are continuously reviewed and are subject to change.

### **Cost of Sales and Margin**

Cost of sales increased approximately 11.8% (\$412.3 million) in fiscal 2005 compared with fiscal 2004 and approximately 11.1% (\$350.5 million) in fiscal 2004 compared with fiscal 2003. These increases primarily reflected the additional sales volume in each of the years. Cost of sales, as a percentage of net sales, was 67.1% in fiscal 2005 and 66.2% in both fiscal 2004 and fiscal 2003. The increase in cost of sales, as a percentage of net sales, during fiscal 2005 was due primarily to the continuing shift in the merchandise mix of sales to more lower-margin consumables and fewer higher-margin discretionary goods, increased inventory shrinkage and increased freight costs due to higher fuel expense. To address inventory shrinkage, the Company is implementing new loss prevention reports that provide more visibility to transaction level issues and is adding personnel to its Loss Prevention Department. In addition, as part of its Urban Initiative, the Company modified its field management structure to increase management presence and the frequency of inspections in urban markets. The opening of the Company's eighth distribution center in Marianna, Florida, in the second quarter of fiscal 2005 positively impacted freight costs by lowering the average distance to the stores from the distribution centers. Increases in productivity and efficiency, such as increased back hauls and optimization and consolidation of inbound routing have also offset some of the cost increases. However, these savings did not fully offset the impact of higher year-over-year fuel costs. The Company expects that the opening of the ninth distribution center in Rome, New York, during the third quarter of fiscal 2006 will positively impact freight costs and continue to offset higher fuel costs.

Cost of sales, as a percentage of net sales, in fiscal 2004 was unchanged from fiscal 2003. The percentage was favorably impacted by a change in the treatment of certain vendor allowances in conformity with an accounting pronouncement, as well as from lower merchandise markdowns. However, the favorable impact of the change in the treatment of certain vendor allowances was offset by a shift in the merchandise mix to more lower-margin basic consumables and relatively less sales of higher-margin discretionary merchandise. Cost of sales, as a percentage of net sales, in fiscal 2004 was also negatively impacted by increased inventory shrinkage and increased freight costs due to higher fuel expense.

During fiscal 2006, the Company expects that cost of sales, as a percentage of net sales, will be flat or increase slightly as compared to fiscal 2005 due to the continuing effect of the shift in the merchandise mix to more lower-margin basic consumables and rising fuel costs. Lower markdowns and lower inventory shrinkage are expected to offset these increases.

### **Selling, General and Administrative Expenses**

Selling, general and administrative ("SG&A") expenses increased approximately 14.1% (\$194.5 million) in fiscal 2005 compared with fiscal 2004, and approximately 12.9% (\$157.7 million) in fiscal 2004 compared with fiscal 2003. The increases in these expenses were attributable primarily to additional costs arising from the continued growth in the number of stores in operation and the continued ramp-up of the eighth distribution center. SG&A expenses, as a percentage of net sales, were 27.0% in fiscal 2005, 26.1% in fiscal 2004 and 25.7% in fiscal 2003. The increase in SG&A expenses, as a percentage of net sales, in fiscal 2005 was due primarily to planned payroll expenses incurred in connection with the urban and cooler initiatives (approximately 0.4% of net sales); increased occupancy and store-related costs (approximately 0.4% of net sales); and increased legal-related costs (approximately 0.1% of net sales). Each of these percentages was negatively impacted by the lower than planned increase in sales in comparable stores. A cumulative charge to correct property tax accruals on leased properties and the incremental costs of three additional advertising circulars also impacted this percentage (approximately 0.2% of net sales), but these amounts were offset by a reduction in bonus costs as the Company did not reach the earnings target necessary for payment of management bonuses. In addition, most other costs, as a percentage of net sales, were negatively impacted by the lower than planned increase in sales in comparable stores.

The increase in SG&A expenses, as a percentage of net sales, in fiscal 2004 was due primarily to below plan sales which negatively impacted the Company's ability to leverage its cost structure. In addition, the effect of the change in treatment of certain vendor allowances negatively impacted expense leverage. Continued increases in insurance costs, primarily workers' compensation, and increased rent expense also adversely impacted expense leverage. The increase in SG&A expense, as a percentage of net sales, for fiscal 2004 was offset slightly by a reduction in bonus costs as the Company did not reach the earnings target necessary for payment of full bonuses.

During fiscal 2006, the Company expects SG&A expense, as a percentage of net sales, to increase as compared to fiscal 2005 due to the expanded rollout of the cooler program and the continued investments in the existing Urban Initiative markets. In addition, the required expensing of stock options and other compensation plan changes will increase SG&A expenses, as a percentage of net sales.

### **Income Taxes**

The effective tax rate was 36.5% in fiscal 2005, 36.6% in fiscal 2004 and 36.5% in fiscal 2003. For fiscal 2006, the Company's plan is for the effective tax rate to increase to 37.0% due to the effect of changes in state income taxes.

### **Liquidity and Capital Resources**

The Company has consistently maintained a strong liquidity position. Cash provided by operating activities during fiscal 2005 was \$299.4 million as compared to \$376.5 million in fiscal 2004 and \$302.3 million in fiscal 2003. These amounts have enabled the Company to fund its regular operating needs, capital expenditure program, cash dividend payments and any repurchase of the Company's Common Stock. In addition, the Company has unsecured revolving credit facilities with banks for short-term borrowings of up to \$200 million. On May 25, 2006, \$100 million of the facilities will expire, and the remaining \$100 million will expire on May 31, 2010. The Company expects that the facilities expiring May 25, 2006, will be extended. The Company had no borrowings against these facilities during fiscal 2005.

Merchandise inventories at the end of fiscal 2005 were 11.3% higher than at the end of fiscal 2004. This increase was due primarily to additional inventory for 432 net new stores. Inventory on a per store basis at the end of fiscal 2005 was 1.8% higher than at the end of fiscal 2004, excluding merchandise in transit to the distribution centers. All of this increase was in hardline merchandise, which increased approximately 4.3% per store, reflecting the early receipt of holiday

merchandise and new inventory associated with the cooler program. Average softline merchandise inventory per store, excluding merchandise in transit to the distribution centers, decreased approximately 5.2% as the Company aggressively managed these items to prevent an inventory buildup.

The increase in capital expenditures to \$229.1 million in fiscal 2005 from \$218.7 million in fiscal 2004 was due primarily to greater distribution center construction expenditures. In addition, the Company installed refrigerated coolers in approximately 1,000 stores. Capital expenditures for fiscal 2006 are expected to be between \$210 and \$225 million and relate primarily to new store openings; existing store expansions, relocations and renovations; construction of distribution centers; expenditures related to store-focused technology infrastructure; and the continued implementation of a refrigerated cooler program for perishable goods in selected stores. The new store expansion and new distribution centers will require additional investment in merchandise inventories.

Capital spending plans, including store opening plans, are continuously reviewed and are subject to change. Cash flow from current operations is expected to be sufficient to meet planned liquidity and operational capital resource needs, including store expansion and other capital spending programs. In addition, the Company has available revolving credit facilities as previously discussed.

During fiscal 2004 and fiscal 2003, the Company purchased in the open market 5.6 million and 2.2 million shares of its Common Stock, respectively, at a cost of \$176.7 million and \$65.9 million, respectively. On April 13, 2005, the Company announced that the Board of Directors authorized the purchase of up to an additional 5 million shares of the Company's Common Stock from time to time as market conditions warrant. On August 19, 2005, the Company announced that the Board of Directors authorized the purchase of an additional \$300 million of the Company's Common Stock from time to time as market conditions warrant. During fiscal 2005, the Company purchased in the open market 3.3 million shares of the Company's Common Stock at a cost of \$92.0 million. As of the end of fiscal 2005, the Company had approximately 18.7 million shares authorized to be purchased.

On September 27, 2005, the Company obtained \$250 million in aggregate proceeds through a private placement under section 4(2) of the Securities Act of 1933, as amended, of the Notes. On October 4, 2005, the Company executed an overnight share repurchase transaction with a bank for the acquisition of 10 million shares, or approximately 6%, of the Company's outstanding Common Stock for an initial purchase price of \$19.97 per share pursuant to the \$300 million repurchase authorization. The proceeds from the Notes were used to finance this transaction. See Note 13 to the Consolidated Financial Statements included in this Report for more information.

The following table shows the Company's obligations and commitments to make future payments under contractual obligations at the end of fiscal 2005 (in thousands):

<u>Contractual Obligations</u>	<u>Payments Due During One Year Fiscal Period Ending</u>						
	<u>Total</u>	<u>August 2006</u>	<u>August 2007</u>	<u>August 2008</u>	<u>August 2009</u>	<u>August 2010</u>	<u>Thereafter</u>
Merchandise letters of credit	\$ 125,613	\$ 125,613	\$ —	\$ —	\$ —	\$ —	\$ —
Operating leases	1,135,810	252,588	225,649	188,636	150,096	107,522	211,319
Construction obligations	58,992	58,992	—	—	—	—	—
Total	<u>\$ 1,320,415</u>	<u>\$ 437,193</u>	<u>\$ 225,649</u>	<u>\$ 188,636</u>	<u>\$ 150,096</u>	<u>\$ 107,522</u>	<u>\$ 211,319</u>

Most of the Company's operating leases provide the Company with an option to extend the term of the lease at designated rates. See Properties herein.

The following table shows the Company's other commercial commitments at the end of fiscal 2005 (in thousands):

<u>Other Commercial Commitments</u>	<u>Total Amounts Committed</u>
Standby letters of credit	\$ 114,979
Surety bonds	6,458
Total	<u>\$ 121,437</u>

At the end of fiscal 2005, approximately \$78.1 million of the merchandise letters of credit were included in accounts payable and accrued liabilities on the Company's balance sheet. A substantial portion of the outstanding amount of standby letters of credit and surety bonds (which are primarily renewed on an annual basis) are used as surety for future premium and

deductible payments to the Company's workers' compensation and general liability insurance carrier. The Company accrues for these future payment liabilities as described in the Critical Accounting Policies section of this MD&A.

### **Recent Accounting Pronouncements**

In December 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 123R which requires all companies to measure compensation cost for all share-based payments (including employee stock options) at fair value, effective for public companies for interim or annual periods beginning after June 15, 2005. The FASB concluded that companies can adopt the new standard in one of two ways: the modified prospective transition method, in which the company would recognize share-based employee compensation from the beginning of the fiscal period in which the recognition provisions are first applied as if the fair-value-based accounting method had been used to account for all employee awards granted, modified, or settled after the effective date and to any awards that were not fully vested as of the effective date; or the modified retrospective transition method, in which a company would recognize employee compensation cost for periods presented prior to the adoption of SFAS No. 123R in accordance with the original provisions of SFAS No. 123 "Accounting for Stock-Based Compensation," pursuant to which a company would recognize employee compensation cost in the amounts reported in the pro forma disclosures provided in accordance with SFAS No. 123. The Company will adopt SFAS No. 123R during the first quarter of fiscal 2006 and will use the modified prospective transition method.

On August 18, 2005, the Compensation Committee of the Board of Directors of the Company approved the acceleration of the vesting date of certain previously issued and outstanding options under the 1989 Non-Qualified Stock Option Plan, effective as of August 26, 2005. The accelerated vesting program applies to: (i) all unvested options that currently have an exercise price in excess of \$40.00/share, including options held by the five most highly compensated executive officers of the Company, and (ii) all unvested options that are "underwater" (i.e. the options have an exercise price in excess of the market value of the stock, determined as of August 26, 2005) and are held by employees at the level of manager or below.

The Company implemented the acceleration program to enhance retention incentives for current employees and to reduce the compensation expense the Company would otherwise be required to recognize as a result of the Company's adoption, effective for fiscal 2006, of SFAS 123R. See Note 1 to the Consolidated Financial Statements included in this Report for information on the impact of the vesting acceleration on the fiscal 2005 pro forma stock-based compensation cost.

During fiscal 2006, the Company expects to incur incremental SG&A expense of approximately \$6 million to \$10 million related to the 1989 Non-Qualified Stock Option Plan as a result of the adoption of SFAS No. 123R. In addition, the Company expects to incur incremental SG&A expense of approximately \$4 million to \$6 million during fiscal 2006 in connection with the expected implementation of new compensation programs, which are designed to improve the linkage between pay and performance.

### **Critical Accounting Policies**

Management believes the following accounting principles are critical because they involve significant judgments, assumptions and estimates used in the preparation of the Company's consolidated financial statements.

#### *Merchandise Inventories:*

Inventories are valued using the retail method, based on retail prices less markon percentages, which approximates the lower of first-in, first-out (FIFO) cost or market. The Company records adjustments to inventory through cost of goods sold when retail price reductions, or markdowns, are taken against on-hand inventory. In addition, management makes estimates and judgments regarding, among other things, initial markups, markdowns, future demand for specific product categories and market conditions, all of which can significantly impact inventory valuation. If actual demand or market conditions are different than those projected by management, additional markdowns may be necessary. This risk is generally higher for seasonal merchandise than for non-seasonal goods. The Company also provides for estimated inventory losses for damaged, lost or stolen inventory for the period from the physical inventory to the financial statement date. These estimates are based on historical experience and other factors.

#### *Property and Equipment:*

Property and equipment is stated at cost. Depreciation for financial reporting purposes is calculated using the straight-line method over the estimated useful lives of the related assets. For leasehold improvements, this depreciation is over the shorter of the term of the related lease (generally five years) or the asset's useful economic life. The valuation and

classification of these assets and the assignment of useful depreciable lives involves significant judgments and the use of estimates. The Company generally assigns no salvage value to property and equipment. Property and equipment is reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Historically, impairment losses on fixed assets have not been material to the Company's financial position and results of operations.

#### *Insurance Liabilities:*

The Company is primarily self-insured for health care, property loss, workers' compensation and general liability costs. These costs are significant primarily due to the large number of the Company's retail locations and employees. Because the nature of these claims is such that there can be a significant lag from the incurrence of the claim (which is when the expense is accrued) until payment is made, the percentage increase in the accrual can be much more pronounced than the percentage increase in the expense. The Company's self-insurance liabilities are based on the total estimated costs of claims filed and estimates of claims incurred but not reported, less amounts paid against such claims, and are not discounted. Management reviews current and historical claims data in developing its estimates. The Company also uses information provided by outside actuaries with respect to workers' compensation and general liability claims. If the underlying facts and circumstances of the claims change or the historical trend is not indicative of future trends, then the Company may be required to record additional expense or a reduction to expense which could be material to the reported financial condition and results of operations.

#### *Lease Accounting:*

The Company leases substantially all of its store properties and accounts for store leases in accordance with SFAS 13, "Accounting for Leases." For purposes of recognizing incentives, premiums and minimum rental expenses on a straight-line basis over terms of the leases, the Company uses the date of initial possession to begin amortization, which is generally when the Company enters the space and begins to make improvements in preparation of intended use. For tenant improvement allowances and rent holidays, the Company records a deferred rent liability at the inception of the lease term and amortizes the deferred rent over the terms of the leases as reductions to rent expense on the Consolidated Statements of Income.

### **Cautionary Statement Regarding Forward-Looking Statements**

Certain statements contained in this Report, or in other public filings, press releases, or other written or oral communications made by the Company or our representatives, which are not historical facts are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements address the Company's plans, activities or events which the Company expects will or may occur in the future and may include express or implied projections of revenue or expenditures, statements of plans and objectives for future operations, growth or initiatives, statements of future economic performance, or statements regarding the outcome or impact of pending or threatened litigation. These forward-looking statements may be identified by the use of the words "plan," "estimate," "expect," "anticipate," "probably," "should," "project," "intend," "continue," and other similar terms and expressions. Various risks, uncertainties and other factors may cause the Company's actual results to differ materially from those expressed or implied in any forward-looking statements. Factors, uncertainties and risks that may result in actual results differing from such forward-looking information include, but are not limited to those listed below, as well as other factors discussed throughout this Report, including without limitation the factors described under "Critical Accounting Policies."

#### *Success of merchandising and marketing programs*

The Company undertakes new programs and refines existing programs to increase net sales and its customer base. The Company may be adversely impacted if merchandise and marketing programs fail to attract customers into its stores or if the merchandising programs implemented by the Company are not attractive to its customers.

#### *Unusual weather or natural disasters that may impact sales and or operations*

Extreme changes in weather patterns or other natural disasters influence customer trends and purchases. Likewise, weather patterns and natural disasters may negatively impact sales and/or operation of the Company.



### *Competitive factors*

The Company is in a highly competitive sector of the discount retail merchandise sector with numerous competitors, some of whom may have greater resources than the Company. The Company competes for customers, merchandise, real estate locations and employees. This competitive environment subjects the Company to various risks, including the ability to continue its store growth and provide attractive merchandise to its customers at competitive prices that allow the Company to maintain its profitability.

### *Pricing pressures, including inflation and energy prices*

Increases in the cost of goods and services, including changes resulting from inflationary pressures, may reduce the Company's profitability and/or sales. The Company's ability to pass on incremental pricing changes may be limited due to operational and/or competitive factors. Increases in prices, including changes in energy prices, may impact the Company's customer base by limiting the amount of discretionary spending of its customers and may impact the Company through increased costs of goods and/or increased operating expenses.

### *Changes in consumer demand and product mix; and changes in overall economic conditions*

A general slowdown in the U.S. economy may adversely affect the spending of the Company's customers, which may result in lower net sales than expected on a quarterly or annual basis. In addition, changes in the types of products made available for sale and the selection of the products by customers affect sales, product mix and margins. Future economic conditions affecting disposable consumer income, such as employment levels, business conditions, fuel and energy costs, interest rates, and tax rates, could also adversely affect the Company's business by reducing spending or causing customers to shift their spending to other products.

### *The impact of acts of war or terrorism and transportation and distribution delays or interruptions*

Significant acts of terrorism, existing U.S. military efforts, as well as the involvement of the U.S. in other military engagements, could have an adverse impact on the Company by, among other things, disrupting its distribution or information systems, causing dramatic increases in fuel prices which increase the cost of doing business, or impeding the flow of imports or domestic products to the Company. Delays or interruptions in the transportation and distribution of products could have an adverse impact on the Company.

### *Merchandise supply and pricing and the interruption of and dependence on imports*

The Company has generally been able to obtain sufficient quantities of attractive merchandise at prices that allow the Company to profitably sell such merchandise. Any disruption in that supply and/or the pricing of such merchandise could negatively impact the Company's operations and results. A significant amount of the goods sold by the Company are imported, and changes to the flow of these goods for any reason could have an adverse impact on the Company.

### *Delays associated with building and opening of distribution facilities and stores and costs of operating distribution facilities and stores*

The Company maintains a network of distribution facilities in its geographic territory, and constructs new facilities to support its growth. In addition, the Company expands its network of stores through opening new stores and remodeling existing stores each year. Delays in opening distribution facilities or stores could adversely affect the Company's future operations by slowing growth, which may in turn reduce revenue growth. Adverse changes in the cost to operate distribution facilities and stores, such as changes in labor, utility, and other operating costs, could have an adverse impact on the Company. Adverse changes in inventory shrinkage at the store-level or in distribution facilities could have a negative impact on the Company.

### *Operational difficulties*

The Company's stores are decentralized and are managed through a network of geographically dispersed management personnel. Inability of the Company to effectively and efficiently operate its stores, including the ability to control losses resulting from inventory shrinkage, may negatively impact the Company's sales and/or margin. In addition, the Company relies upon its distribution and logistics network to provide goods to stores in a timely and cost-effective manner; any disruption, unanticipated expense or operational failure related to this process could negatively impact store operations. Finally, the Company's operations are facilitated by the use of various technologies, the disruption or failure of which could negatively impact the Company's operations.

### *Higher costs, potential problems and achievement of targeted results associated with the implementation of new programs, systems and technology*

The Company is undertaking a variety of operating initiatives as well as infrastructure initiatives. The failure to properly execute any of these initiatives could have an adverse impact on the future operating results of the Company.

### *Changes in state or federal legislation or regulations, including the effects of legislation and regulations on wage levels and entitlement programs; changes in currency exchange rates, trade restrictions, tariffs, quotas and freight rates*

Unanticipated changes in federal or state wage requirements or other changes in workplace regulation could adversely impact the Company's ability to achieve its financial targets. Because a substantial amount of the Company's imported merchandise comes from China, a change in the Chinese currency policy could negatively impact the Company's merchandise costs. Changes in trade restrictions, new tariffs and quotas, and higher shipping costs for goods could also adversely impact the ability of the Company to achieve anticipated operating results.

### *Success of new store opening program*

The Company's growth is dependent on both increases in sales in existing stores and the ability to open new stores. Unavailability of store locations that the Company deems attractive, delays in the acquisition or opening of new stores, difficulties in staffing and operating new store locations and lack of customer acceptance of stores in expanded market areas all may negatively impact the Company's new store growth, the costs associated with new stores and/or the profitability of new stores.

### *Changes in the Company's ability to attract and retain employees, and changes in health care and other insurance costs*

The growth of the Company could be adversely impacted by its inability to attract and retain employees at the store operations level, in distribution facilities, and at the corporate level, including the Company's senior management team. Adverse changes in health care costs could also adversely impact the Company's ability to achieve its operational and financial goals and to offer attractive benefit programs to its employees.

### *Adverse impacts associated with legal proceedings and claims*

The Company is a party in a variety of legal proceedings and claims, including those described elsewhere in this Report. Operating results for the Company could be adversely impacted if legal proceedings and claims against the Company are made, requiring the payment of cash towards those proceedings or changes to the operation of the business.

All of the forward-looking statements made by the Company in this Report and other documents or statements are qualified by these and other factors, risks and uncertainties. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this Report. The Company does not undertake to publicly update or revise its forward-looking statements even if experience or future changes make it clear that projected results expressed or implied in such statements will not be realized.

## **ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company is subject to market risk from exposure to changes in interest rates based on its financing, investing and cash management activities. The Company maintains unsecured revolving credit facilities at variable interest rates to meet the short-term needs of its expansion program and seasonal inventory increases.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

**FAMILY DOLLAR STORES, INC.**

Report of Independent Registered Public Accounting Firm

Consolidated Statements of Income for fiscal 2005, fiscal 2004 and fiscal 2003

Consolidated Balance Sheets as of August 27, 2005, and August 28, 2004

Consolidated Statement of Shareholders' Equity for fiscal 2005, fiscal 2004 and fiscal 2003

Consolidated Statement of Cash Flows for fiscal 2005, fiscal 2004 and fiscal 2003

Notes to Consolidated Financial Statements

## Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Family Dollar Stores, Inc:

We have completed an integrated audit of Family Dollar Stores, Inc.'s August 27, 2005 consolidated financial statements and of its internal control over financial reporting as of August 27, 2005 and audits of its August 28, 2004 and August 30, 2003 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

### *Consolidated financial statements*

In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a)(1) present fairly, in all material respects, the financial position of Family Dollar Stores, Inc., and its subsidiaries at August 27, 2005 and August 28, 2004, and the results of their operations and their cash flows for each of the three years in the period ended August 27, 2005 in conformity with accounting principles generally accepted in the United States of America. 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 of these statements 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 of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

### *Internal control over financial reporting*

Also, in our opinion, management's assessment, included in Management's Report on Internal Control Over Financial Reporting appearing under Item 9A, that the Company maintained effective internal control over financial reporting as of August 27, 2005 based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of August 27, 2005, based on criteria established in *Internal Control - Integrated Framework* issued by the COSO. The Company'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 opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting 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. An audit of internal control over financial reporting includes 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 consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

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 (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) 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 (iii) 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.

PricewaterhouseCoopers LLP  
Charlotte, North Carolina  
November 2, 2005

**FAMILY DOLLAR STORES, INC., AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**

(in thousands, except per share amounts)	Years Ended		
	August 27, 2005	August 28, 2004	August 30, 2003
Net sales	\$ 5,824,808	\$ 5,281,888	\$ 4,750,171
Costs and expenses:			
Cost of sales	3,908,569	3,496,278	3,145,788
Selling, general and administrative	1,573,444	1,378,948	1,221,239
Cost of sales and operating expenses	<u>5,482,013</u>	<u>4,875,226</u>	<u>4,367,027</u>
Income before income taxes	342,795	406,662	383,144
Income taxes (Note 6)	<u>125,286</u>	<u>148,758</u>	<u>139,835</u>
Net income	<u>\$ 217,509</u>	<u>\$ 257,904</u>	<u>\$ 243,309</u>
Net income per common share - basic (Note 10)	<u>\$ 1.30</u>	<u>\$ 1.51</u>	<u>\$ 1.41</u>
Average shares - basic (Note 10)	<u>166,791</u>	<u>170,770</u>	<u>172,346</u>
Net income per common share - diluted (Note 10)	<u>\$ 1.30</u>	<u>\$ 1.50</u>	<u>\$ 1.40</u>
Average shares - diluted (Note 10)	<u>167,092</u>	<u>171,624</u>	<u>173,354</u>

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

**FAMILY DOLLAR STORES, INC., AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

(in thousands, except per share and share amounts)	August 27, 2005	August 28, 2004
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 105,175	\$ 87,023
Investment securities (Note 2)	33,530	120,840
Merchandise inventories	1,090,791	980,124
Deferred income taxes (Note 6)	100,493	84,084
Income tax refund receivable	-	1,304
Prepayments and other current assets	24,779	16,937
Total current assets	1,354,768	1,290,312
Property and equipment, net (Note 3)	1,027,475	918,449
Other assets	27,258	15,600
	\$ 2,409,501	\$ 2,224,361
 <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 574,831	\$ 534,405
Accrued liabilities (Note 5)	315,508	266,180
Income taxes payable	4,272	-
Total current liabilities	894,611	800,585
Deferred income taxes (Note 6)	\$ 86,824	\$ 86,694
Commitments and contingencies (Note 8)		
Shareholders' Equity: (Notes 9 and 10)		
Preferred stock, \$1 par; authorized and unissued 500,000 shares		
Common stock, \$.10 par; authorized 600,000,000 shares; issued 188,871,738 shares at August 27, 2005, and 187,671,318 shares at August 28, 2004, and outstanding 165,262,513 shares at August 27, 2005, and 167,396,998 shares at August 28, 2004	18,887	18,767
Capital in excess of par	133,743	106,853
Retained earnings	1,654,861	1,498,890
	1,807,491	1,624,510
Less: common stock held in treasury, at cost (23,609,225 shares at August 27, 2005, and 20,274,320 shares at August 28, 2004)	379,425	287,428
	1,428,066	1,337,082
	\$ 2,409,501	\$ 2,224,361

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

**FAMILY DOLLAR STORES, INC., AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
**Years Ended August 27, 2005, August 28, 2004, and August 30, 2003**

<u>(in thousands, except per share and share amounts)</u>	<u>Common stock</u>	<u>Capital in excess of par</u>	<u>Retained earnings</u>	<u>Treasury stock</u>
<b>Balance, August 31, 2002</b> (185,830,901 shares common stock; 12,501,666 shares treasury stock)	\$ 18,583	\$ 63,294	\$ 1,103,644	\$ 44,944
Net income for the year			243,309	
Issuance of 1,079,092 common shares under employee stock option plan, including tax benefits (Note 9)	108	24,098		
Purchase of 2,202,200 common shares for treasury				65,851
Issuance of 2,583 shares of treasury stock under the Family Dollar 2000 Outside Directors Plan		65		(16)
<u>Less dividends on common stock, \$.29 per share</u>			<u>(49,890)</u>	
<b>Balance, August 30, 2003</b> (186,909,993 shares common stock; 14,701,283 shares treasury stock)	18,691	87,457	1,297,063	110,779
Net income for the year			257,904	
Issuance of 761,325 common shares under employee stock option plan, including tax benefits (Note 9)	76	19,318		
Purchase of 5,576,100 common shares for treasury				176,674
Issuance of 3,063 shares of treasury stock under the Family Dollar 2000 Outside Directors Plan		78		(25)
<u>Less dividends on common stock, \$.33 per share</u>			<u>(56,077)</u>	
<b>Balance, August 28, 2004</b> (187,671,318 shares common stock; 20,274,320 shares treasury stock)	18,767	106,853	1,498,890	287,428
Net income for the year			217,509	
Issuance of 1,200,420 common shares under employee stock option plan, including tax benefits (Note 9)	120	26,829		
Purchase of 3,338,500 common shares for treasury				92,049
Issuance of 3,595 shares of treasury stock under the Family Dollar 2000 Outside Directors Plan		61		(52)
<u>Less dividends on common stock, \$.37 per share</u>			<u>(61,538)</u>	
<b>Balance, August 27, 2005</b> (188,871,738 shares common stock; 23,609,225 shares treasury stock)	<u>\$ 18,887</u>	<u>\$ 133,743</u>	<u>\$ 1,654,861</u>	<u>\$ 379,425</u>

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

**FAMILY DOLLAR STORES, INC., AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)	Years Ended		
	August 27, 2005	August 28, 2004	August 30, 2003
<b>Cash flows from operating activities:</b>			
Net income	\$ 217,509	\$ 257,904	\$ 243,309
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	114,733	102,010	92,360
Deferred income taxes	(16,279)	(4,268)	(3,740)
Tax benefit from stock option exercises	3,700	4,476	6,815
Loss on disposition of property and equipment	3,306	4,311	3,905
Changes in operating assets and liabilities:			
Merchandise inventories	(110,667)	(125,754)	(87,739)
Income tax refund receivable	1,304	(1,304)	6,469
Prepayments and other current assets	(7,842)	16,685	(21,069)
Other assets	(11,658)	1,480	(3,937)
Accounts payable and accrued liabilities	100,974	121,608	65,277
Income taxes payable	4,272	(671)	671
	<u>299,352</u>	<u>376,477</u>	<u>302,321</u>
<b>Cash flows from investing activities:</b>			
Purchases of investment securities	(280,100)	(282,265)	(281,859)
Sales of investment securities	367,410	365,924	249,110
Capital expenditures	(229,065)	(218,748)	(220,285)
Proceeds from dispositions of property and equipment	2,000	1,550	1,051
	<u>(139,755)</u>	<u>(133,539)</u>	<u>(251,983)</u>
<b>Cash flows from financing activities:</b>			
Purchases of stock for treasury	(91,997)	(176,649)	(65,835)
Change in cash overdrafts	(12,675)	(20,501)	18,381
Proceeds from exercise of stock options	23,310	14,996	17,456
Payment of dividends	(60,083)	(54,755)	(48,242)
	<u>(141,445)</u>	<u>(236,909)</u>	<u>(78,240)</u>
Net increase (decrease) in cash and cash equivalents	18,152	6,029	(27,902)
Cash and cash equivalents at beginning of year	87,023	80,994	108,896
Cash and cash equivalents at end of year	<u>\$ 105,175</u>	<u>\$ 87,023</u>	<u>\$ 80,994</u>
<b>Supplemental disclosures of cash flow information</b>			
Cash paid during the period for:			
Purchases of property and equipment awaiting processing for payment, included in accounts payable	\$ 12,239	\$ 14,272	\$ 15,077
Interest	—	—	—
Income taxes	132,288	150,525	129,619

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



**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**Years Ended August 27, 2005, August 28, 2004, and August 30, 2003**

**1. Description of Business and Summary of Significant Accounting Policies:**

**Description of business:**

The Company operates a chain of neighborhood retail discount stores in 44 contiguous states. The Company manages its business on the basis of one reportable segment. The Company's products include hardline merchandise such as household products, health and beauty aids, and snacks and other food, and softline merchandise such as clothing, shoes and domestic items.

**Principles of consolidation:**

The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly owned. All significant intercompany balances and transactions have been eliminated.

**Cash equivalents:**

The Company considers all highly liquid investments with an original maturity of three months or less to be "cash equivalents." The carrying amount of the Company's cash equivalents approximates fair value due to the short maturities of these investments and consists primarily of money market funds and other overnight investments. The Company maintains cash deposits with major banks, which from time to time may exceed federally insured limits. The Company periodically assesses the financial condition of the institutions and believes that the risk of any loss is minimal.

**Investment securities:**

The items classified as investment securities are principally auction rate securities and variable rate demand notes. The Company classifies all investment securities as available-for-sale. Securities accounted for as available-for-sale are required to be reported at fair value with unrealized gains and losses, net of taxes, excluded from net income and shown separately as a component of accumulated other comprehensive income within stockholders' equity. The securities that the Company has classified as available-for-sale generally trade at par and as a result typically do not have any realized or unrealized gains or losses.

**Merchandise inventories:**

Inventories are valued using retail prices less markon percentages and approximate the lower of first-in, first-out (FIFO) cost or market.

**Property and equipment:**

Property and equipment is stated at cost. Depreciation for financial reporting purposes is calculated using the straight-line method over the estimated useful lives of the related assets. For leasehold improvements, this depreciation is over the shorter of the term of the related lease (generally five years) or the asset's useful economic life.

Estimated useful lives are as follows:

Buildings and building improvements	10-40 years
Furniture, fixtures and equipment	3-10 years
Transportation equipment	3-10 years
Leasehold improvements	5-10 years

The Company capitalizes certain costs incurred in connection with developing, obtaining and implementing software for internal use. Capitalized costs are amortized over the expected economic life of the assets, generally ranging from five to eight years.

Property and equipment is reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

**Revenues:**

The Company recognizes revenue, net of returns, at the time the customer tenders payment for and takes possession of the merchandise.

**Insurance liabilities:**

The Company is primarily self-insured for health care, property loss, workers' compensation and general liability costs. These liabilities are based on the total estimated costs of claims filed and estimates of claims incurred but not reported, less amounts paid against such claims, and are not discounted.

**Advertising costs:**

Advertising costs, net of co-op recoveries from vendors, are expensed on the commencement of the advertisement and amounted to \$4.7 million and \$2.0 million in fiscal 2005 and fiscal 2004 respectively. Net advertising expense amounts were not material in fiscal 2003.

**Vendor allowances:**

Cash consideration received from a vendor is presumed to be a reduction of the purchase cost of merchandise and is reflected as a reduction of cost of sales unless it can be demonstrated this offsets an incremental expense, in which case it can be netted against that expense.

**Store opening and closing costs:**

The Company charges pre-opening costs against operating results when incurred. For properties under operating lease agreements, the present value of any remaining liability under the lease, net of expected sublease and lease termination recoveries, is expensed when the closing occurs.

**Selling, general and administrative expenses:**

Buying, distribution center and occupancy costs, including depreciation, are included in selling, general and administrative expenses.

**Operating leases:**

Except for its corporate headquarters and distribution centers, the Company generally conducts its operations from leased facilities. Generally, store real estate leases are for initial terms of from five to ten years with multiple renewal options for additional five-year periods. Certain leases provide for contingent rental payments based upon a percentage of store sales.

For purposes of recognizing incentives, premiums and minimum rental expenses on a straight-line basis over terms of the leases, the Company uses the date of initial possession to begin amortization, which is generally when the Company enters the space and begins to make improvements in preparation of intended use. For tenant improvement allowances and rent holidays, the Company records a deferred rent liability at the inception of the lease term and amortizes the deferred rent over the terms of the leases as reductions to rent expense on the Consolidated Statements of Income. The Company also has long-term leases for equipment generally with lease terms of five years or less.

**Income taxes:**

The Company records deferred income tax assets and liabilities for the expected future tax consequences of temporary differences between the financial reporting bases and the income tax bases of its assets and liabilities.

**Stock options:**

The Company accounts for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25"), and related Interpretations. The exercise price of options awarded under the Company's 1989 Non-Qualified Stock Option Plan has been equal to the fair market value of the underlying Common Stock on the date of grant. Accordingly, no compensation expense has been recognized for options granted under the plan. Income tax benefits attributable to stock options exercised are credited to capital in excess of par.

The Company utilizes the disclosure-only provisions of Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure." If compensation cost for the Company's stock-based compensation plan had been determined based on fair value at the grant date for awards under this plan consistent with the methodology prescribed under this statement, net income and net income per share would have been reduced to the pro forma amounts indicated in the table below (in thousands, except per share amounts):

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Net income — as reported	\$ 217,509	\$ 257,904	\$ 243,309
Pro forma stock-based compensation cost	(15,374)	(8,062)	(5,988)
Net income — pro forma	<u>\$ 202,135</u>	<u>\$ 249,842</u>	<u>\$ 237,321</u>
Net income per share — as reported			
basic	\$ 1.30	\$ 1.51	\$ 1.41
diluted	\$ 1.30	\$ 1.50	\$ 1.40
Net income per share — pro forma			
basic	\$ 1.21	\$ 1.46	\$ 1.38
diluted	\$ 1.21	\$ 1.46	\$ 1.37

The increase in pro forma stock-based compensation cost in fiscal 2005 was a result of the acceleration of certain “underwater” (i.e. the options have an exercise price in excess of the market value of the stock, determined as of August 26, 2005) options. On August 18, 2005, the Compensation Committee of the Board of Directors of the Company approved the acceleration of the vesting date of certain previously issued and outstanding options under the 1989 Non-Qualified Stock Option Plan, effective as of August 26, 2005. The accelerated vesting program applies to: (i) all unvested options that currently have an exercise price in excess of \$40.00/share, including options held by the five most highly compensated executive officers of the Company, and (ii) all unvested options that are underwater and are held by employees at the level of manager or below.

The Company implemented the acceleration program to enhance retention incentives for current employees and to reduce the compensation expense the Company would otherwise be required to recognize as a result of the Company’s adoption, effective for fiscal 2006, of SFAS 123R. The future expense eliminated as a result of the option acceleration program was approximately \$12.9 million, or \$8.2 million net of taxes over a period of four years during which the options would have vested.

#### **New accounting pronouncement**

In December 2004, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 123R which requires all companies to measure compensation cost for all share-based payments (including employee stock options) at fair value, effective for public companies for interim or annual periods beginning after June 15, 2005. The FASB concluded that companies can adopt the new standard in one of two ways: the modified prospective transition method, in which the company would recognize share-based employee compensation from the beginning of the fiscal period in which the recognition provisions are first applied as if the fair-value-based accounting method had been used to account for all employee awards granted, modified, or settled after the effective date and to any awards that were not fully vested as of the effective date; or the modified retrospective transition method, in which a company would recognize employee compensation cost for periods presented prior to the adoption of SFAS No. 123R in accordance with the original provisions of SFAS No. 123 “Accounting for Stock-Based Compensation,” pursuant to which a company would recognize employee compensation cost in the amounts reported in the pro forma disclosures provided in accordance with SFAS No. 123. The Company will adopt SFAS No. 123R during the first quarter of fiscal 2006 and will use the modified prospective transition method. During fiscal 2006, the Company expects to incur incremental SG&A expense of approximately \$6 million to \$10 million related to the 1989 Non-Qualified Stock Option Plan as a result of the adoption of SFAS No. 123R.

#### **Fiscal year:**

The Company’s fiscal year generally ends on the Saturday closest to August 31.

#### **Use of estimates:**

The preparation of the Company’s consolidated financial statements, in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

#### **Reclassifications and other:**

Certain reclassifications of the fiscal 2003 and fiscal 2004 amounts have been made to conform to the fiscal 2005 presentation. The fourth quarter of fiscal 2005 included an \$8.4 million cumulative pre-tax charge to correct property tax accruals on leased properties.

## 2. Investment Securities

The Company's investments consist of the following short-term available-for-sale securities (in thousands):

<u>Auction Rate Securities And Variable Rate Demand Notes</u>	<u>Amortized Cost</u>	<u>Gross Unrealized Holding Gains</u>	<u>Gross Unrealized Holding Losses</u>	<u>Fair Value</u>
August 27, 2005	\$ 33,530	—	—	\$ 33,530
August 28, 2004	\$ 120,840	—	—	\$ 120,840

Proceeds from sales of short-term investment securities available-for-sale during fiscal 2005, fiscal 2004 and fiscal 2003 were \$367,410, \$365,924, and \$249,110, respectively. No gains or losses were realized on those sales for fiscal 2005, fiscal 2004 and fiscal 2003.

## 3. Property and Equipment:

<u>(in thousands)</u>	<u>August 27, 2005</u>	<u>August 28, 2004</u>
Buildings and building improvements	\$ 445,826	\$ 390,363
Furniture, fixtures and equipment	779,895	669,011
Transportation equipment	68,173	60,289
Leasehold improvements	270,156	212,968
Construction in progress	38,871	59,453
	<u>1,602,921</u>	<u>1,392,084</u>
Less accumulated depreciation and amortization	<u>642,190</u>	<u>535,765</u>
	960,731	856,319
Land	66,744	62,130
	<u>\$ 1,027,475</u>	<u>\$ 918,449</u>

## 4. Revolving Credit Facilities and Short-Term Borrowings:

The Company has unsecured revolving credit facilities with banks for short-term borrowings of up to \$200 million. On May 25, 2006, \$100 million of the facilities will expire, and the remaining \$100 million will expire on May 31, 2010. The Company expects that the facilities expiring on May 25, 2006, will be extended. Any borrowings under these facilities are at a variable interest rate based on short-term market interest rates. The Company had no borrowings against these facilities during fiscal 2005, fiscal 2004 or fiscal 2003.

## 5. Accrued Liabilities:

<u>(in thousands)</u>	<u>August 27, 2005</u>	<u>August 28, 2004</u>
Compensation	\$ 44,397	\$ 46,066
Self-insurance liabilities	157,134	124,343
Taxes other than income taxes	43,217	36,436
Deferred rent	42,728	28,773
Other	28,032	30,562
	<u>\$ 315,508</u>	<u>\$ 266,180</u>

## 6. Income Taxes:

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities as of the end of fiscal 2005 and the end of fiscal 2004, were as follows (in thousands):

	<u>August 27, 2005</u>	<u>August 28, 2004</u>
Deferred income tax liabilities:		
Excess of book over tax basis of property and equipment	\$ 86,824	\$ 86,694
Deferred income tax assets:		
Excess of tax over book basis of inventories	\$ 14,901	\$ 17,019
Currently nondeductible accruals for:		
Self-insurance	60,308	47,723
Compensation	8,980	7,137
Deferred rent	12,227	6,743
Other	4,077	5,462
Total deferred income tax assets	<u>\$ 100,493</u>	<u>\$ 84,084</u>

The provisions for income taxes in fiscal 2005, fiscal 2004 and fiscal 2003 were as follows (in thousands):

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Current:			
Federal	\$ 126,497	\$ 138,508	\$ 130,923
State	15,068	14,518	12,652
	<u>141,565</u>	<u>153,026</u>	<u>143,575</u>
Deferred:			
Federal	(14,463)	(3,782)	(3,773)
State	(1,816)	(486)	33
	<u>(16,279)</u>	<u>(4,268)</u>	<u>(3,740)</u>
Total	<u>\$ 125,286</u>	<u>\$ 148,758</u>	<u>\$ 139,835</u>

The following table summarizes the components of income tax expense in fiscal 2005, fiscal 2004 and fiscal 2003 (in thousands):

	<u>2005</u>		<u>2004</u>		<u>2003</u>	
	<u>Income tax expense</u>	<u>% of pre-tax income</u>	<u>Income tax expense</u>	<u>% of pre-tax income</u>	<u>Income tax expense</u>	<u>% of pre-tax income</u>
Computed "expected" federal income tax	\$ 119,978	35.0	\$ 142,331	35.0	\$ 134,100	35.0
State income taxes, net of federal income tax benefit	8,632	2.5	9,391	2.3	8,179	2.1
Other	(3,324)	(1.0)	(2,964)	(0.7)	(2,444)	(0.6)
Actual income tax expense	<u>\$ 125,286</u>	<u>36.5</u>	<u>\$ 148,758</u>	<u>36.6</u>	<u>\$ 139,835</u>	<u>36.5</u>

The Internal Revenue Service is currently examining the Company's consolidated federal income tax returns for fiscal 2004 and fiscal 2003. Although the ultimate outcome of the examination cannot be presently determined, the Company believes that it has made adequate provision for federal income taxes with respect to all open years.

## 7. Employee Benefit Plans:

### Incentive compensation plan:

The Company has an incentive profit-sharing plan which provides that, at the discretion of the Board of Directors, the Company may pay certain employees and officers an aggregate amount not to exceed 5% of the Company's consolidated income before income taxes. There were no expenses under the profit-sharing plan in fiscal 2005. Expenses under the profit-sharing plan were \$5.5 million in fiscal 2004 and \$7.3 million in fiscal 2003.

**Compensation deferral plans:**

The Company has a voluntary compensation deferral plan, under Section 401(k) of the Internal Revenue Code, available to eligible employees. At the discretion of the Board of Directors, the Company makes contributions to the plan which are allocated to participants, and in which they become vested, in accordance with formulas and schedules defined by the plan. Company expenses for contributions to the plan were \$3.0 million in fiscal 2005, \$2.7 million in fiscal 2004 and \$2.3 million in fiscal 2003.

In fiscal 2003, the Company adopted a deferred compensation plan to provide certain key management employees the ability to defer a portion of their base compensation and bonuses. The plan is an unfunded nonqualified plan. The deferred amounts and earnings thereon are payable to participants, or designated beneficiaries, at specified future dates, upon retirement or death. The Company does not make contributions to this plan or guarantee earnings.

**8. Commitments and Contingencies:****Operating leases:**

Rental expenses on all operating leases, both cancelable and non-cancelable, for fiscal 2005, fiscal 2004 and fiscal 2003 were as follows (in thousands):

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Minimum rentals, net of minor sublease rentals	\$ 274,562	\$ 238,188	\$ 210,268
Contingent rentals	4,670	4,722	5,134
	<u>\$ 279,232</u>	<u>\$ 242,910</u>	<u>\$ 215,402</u>

The following table shows the Company's obligations and commitments to make future payments under contractual obligations, including future minimum rental payments required under operating leases that have initial or remaining non-cancelable lease terms in excess of one year at the end of fiscal 2005 (in thousands):

	<u>Payments Due During One Year Fiscal Period Ending</u>						
	<u>Total</u>	<u>August 2006</u>	<u>August 2007</u>	<u>August 2008</u>	<u>August 2009</u>	<u>August 2010</u>	<u>Thereafter</u>
<b>Contractual Obligations</b>							
Merchandise letters of credit	\$ 125,613	\$ 125,613	\$ —	\$ —	\$ —	\$ —	\$ —
Operating leases	1,135,810	252,588	225,649	188,636	150,096	107,522	211,319
Construction obligations	58,992	58,992	—	—	—	—	—
Total	<u>\$ 1,320,415</u>	<u>\$ 437,193</u>	<u>\$ 225,649</u>	<u>\$ 188,636</u>	<u>\$ 150,096</u>	<u>\$ 107,522</u>	<u>\$ 211,319</u>

Most of the Company's operating leases provide the Company with an option to extend the term of the lease at designated rates.

The following table shows the Company's other commercial commitments at the end of fiscal 2005 (in thousands):

<u>Other Commercial Commitments</u>	<u>Total Amounts Committed</u>
Standby letters of credit	\$ 114,979
Surety bonds	6,458
Total	<u>\$ 121,437</u>

At the end of fiscal 2005, approximately \$78.1 million of the merchandise letters of credit are included in accounts payable on the Company's consolidated balance sheet. A substantial portion of the outstanding amount of standby letters of credit and surety bonds (which are primarily renewed on an annual basis) are used as surety for future premium and deductible payments to the Company's workers' compensation and general liability insurance carrier. The Company accrues for these liabilities based on the total estimated costs of claims filed and claims incurred but not reported, and are not discounted.

**Litigation:**

On January 30, 2001, Janice Morgan and Barbara Richardson, two individuals who have held the position of Store Manager for subsidiaries of the Company, filed a Complaint against the Company in the United States District Court for the Northern District of Alabama. Thereafter, pursuant to the Court's ruling, notice of the pendency of the lawsuit was sent to approximately 13,000 current and former Store Managers holding the position on or after July 1, 1999. Approximately 2,550 of those receiving such notice filed consent forms and joined the lawsuit as plaintiffs, including approximately 2,300 former Store Managers and approximately 250 then current employees. After rulings by the Court on motions to dismiss certain plaintiffs filed by the Company and motions to reconsider filed by plaintiffs, 1,424 plaintiffs remained in the case at the commencement of trial.

The case has proceeded as a collective action under the Fair Labor Standards Act ("FLSA"). The Complaint alleges that the Company violated the FLSA by classifying the named plaintiffs and other similarly situated current and former Store Managers as "exempt" employees who are not entitled to overtime compensation. Plaintiffs seek to recover unpaid overtime compensation in an amount currently estimated to be up to approximately \$50 million, liquidated damages equal to the overtime award, if any, plus an award of attorneys' fees, costs and expenses, and such other relief as the Court may deem proper.

A jury trial in this case commenced on June 13, 2005, in Tuscaloosa, Alabama, and ended on June 28, 2005, with the judge declaring a mistrial after the jury was unable to reach a unanimous decision in the matter. The case is scheduled to be retried commencing on February 21, 2006.

In general, the Company continues to believe that the Store Managers are "exempt" employees under the FLSA and have been properly compensated and that the Company has meritorious defenses that should enable it ultimately to prevail. However, the outcome of any litigation is inherently uncertain. Resolution of this matter could have a material adverse effect on the Company's financial position, liquidity or results of operation.

The Company is involved in numerous other legal proceedings and claims incidental to its business, including litigation related to alleged failures to comply with various state and federal employment laws. While the ultimate outcome cannot be determined, the Company currently believes that these proceedings and claims, both individually and in the aggregate, should not have a material adverse effect on the Company's financial position, liquidity or results of operations. However, the outcome of any litigation is inherently uncertain and, if decided adversely to the Company, the Company may be subject to liability that could have a material adverse effect on the Company's financial position, liquidity or results of operations.

**9. Employee Stock Option Plan:**

The Company's 1989 Non-Qualified Stock Option Plan provides for the granting of options to key employees to purchase shares of Common Stock at prices not less than fair market value on the date of the grant. Options expire five years from the date of grant and are exercisable to the extent of 40% after the second anniversary of the grant and an additional 30% at each of the following two anniversary dates on a cumulative basis.

If the provisions of SFAS No. 123 expensing had been applied, the Company's net income and net income per common share would have been impacted as summarized in the discussion of the Company's stock option accounting policy in Note 1.

The average fair value of options granted during fiscal 2005, fiscal 2004 and fiscal 2003 is \$6.85, \$11.47 and \$9.14 per share, respectively.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Expected dividend yield	1.25%	0.75%	0.89%
Expected stock price volatility	31.82%	36.49%	41.54%
Weighted average risk-free interest rate	3.52%	3.06%	2.74%
Expected life of options (years)	3.5	3.5	3.5

These assumptions are evaluated and revised, as necessary, to reflect market conditions and experience.

The summary of the status of the Company's stock-based compensation plan as of the end of fiscal 2005, fiscal 2004 and fiscal 2003, and changes during the years then ended were as follows (in thousands, except per share amounts):

	<u>Options Outstanding</u>	<u>Range of Option Prices Per Share</u>	<u>Weighted Average Exercise Price</u>
Balance, August 31, 2002	4,411	\$ 11.38 to \$ 35.50	\$ 20.05
Granted	1,793	24.75 to 39.00	28.99
Exercised	(1,079)	11.38 to 27.75	16.11
Canceled	(124)	15.00 to 37.50	24.95
Balance, August 30, 2003	5,001	\$ 14.75 to \$ 39.00	\$ 23.99
Granted	2,036	26.00 to 44.00	39.56
Exercised	(761)	14.75 to 31.25	19.60
Canceled	(320)	16.00 to 42.25	30.55
Balance, August 28, 2004	5,956	\$ 14.75 to \$ 44.00	\$ 29.52
Granted	2,113	20.75 to 33.25	26.99
Exercised	(1,200)	14.75 to 32.25	18.71
Canceled	(807)	16.00 to 44.00	32.05
Balance, August 27, 2005	<u>6,062</u>	\$ 17.75 to \$ 44.00	\$ 30.44

At the end of fiscal 2005, fiscal 2004 and fiscal 2003, options for 3.6 million, 1.2 million, and 1.0 million shares were exercisable, respectively.

The following table summarizes information about stock options outstanding at the end of fiscal 2005 (in thousands, except per share amounts):

<u>Range of Exercise Prices</u>	<u>Options Outstanding</u>			<u>Options Exercisable</u>	
	<u>Number Outstanding at August 27, 2005</u>	<u>Weighted Average Remaining Contractual Life</u>	<u>Weighted Average Exercise Price</u>	<u>Number Exercisable at August 27, 2005</u>	<u>Weighted Average Exercise Price</u>
\$ 17.75 to \$ 26.99	1,251	1.81 years	\$ 24.19	852	\$ 24.28
27.00 to 34.75	3,276	3.22	28.14	1,274	28.39
34.76 to 44.00	1,535	3.07	40.46	1,462	40.62
\$ 17.75 to \$ 44.00	<u>6,062</u>	2.89 years	\$ 30.44	<u>3,588</u>	\$ 32.40

At the end of fiscal 2005, fiscal 2004 and fiscal 2003, shares available for granting of stock options under the Company's stock option plan were 4.2 million, 5.5 million and 7.2 million shares, respectively.

#### 10. Common Stock:

Basic net income per common share is computed by dividing net income by the weighted average number of shares outstanding during each period. Diluted net income per common share gives effect to all securities representing potential common shares that were dilutive and outstanding during the period. The exercise prices for certain of the outstanding stock options that the Company has awarded exceed the average market price of the Company's Common Stock. Such stock options are antidilutive (options for 3.4 million, 2.0 million and 0.5 million at the end of fiscal 2005, fiscal 2004 and fiscal 2003, respectively) and were not included in the computation of diluted net income per common share. In the calculation of diluted net income per common share, the denominator includes the number of additional common shares that would have been outstanding if the Company's outstanding dilutive stock options had been exercised.

During fiscal 2004 and fiscal 2003, the Company purchased in the open market 5.6 million and 2.2 million shares of its Common Stock, respectively, at a cost of \$176.7 million and \$65.9 million, respectively. On April 13, 2005, the Company announced that the Board of Directors authorized the purchase of up to an additional 5 million shares of the Company's Common Stock from time to time as market conditions warrant. On August 19, 2005, the Company announced that the Board of Directors authorized the purchase of an additional \$300 million of the Company's Common Stock from time to time as market conditions warrant. During fiscal 2005, the Company purchased in the open market 3.3 million shares of the



Company's Common Stock at a cost of \$92.0 million. As of the end of fiscal 2005, the Company had approximately 18.7 million shares authorized to be purchased.

The following table sets forth the computation of basic and diluted net income per common share (in thousands, except per share amounts):

	<u>2005</u>	<u>2004</u>	<u>2003</u>
<b>Basic net income per share:</b>			
Net income	\$ 217,509	\$ 257,904	\$ 243,309
Weighted average number of shares outstanding	166,791	170,770	172,346
Net income per common share — basic	\$ 1.30	\$ 1.51	\$ 1.41
<b>Diluted net income per share:</b>			
Net income	\$ 217,509	\$ 257,904	\$ 243,309
Weighted average number of shares outstanding	166,791	170,770	172,346
Effect of dilutive securities — stock options	301	854	1,008
Average shares — diluted	167,092	171,624	173,354
Net income per common share — diluted	\$ 1.30	\$ 1.50	\$ 1.40

#### 11. Unaudited Summaries of Quarterly Results:

<u>(in thousands, except per share amounts)</u>	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth Quarter</u>
<b>2005</b>				
Net sales	\$ 1,380,245	\$ 1,586,754	\$ 1,427,966	\$ 1,429,843
Gross margin	460,352	520,919	479,352	455,616
Net income	54,429	80,073	53,774	29,233 <sup>(1)</sup>
Net income per common share <sup>(2)</sup>	\$ 0.32	\$ 0.48	\$ 0.32	\$ 0.18 <sup>(1)</sup>
<b>2004</b>				
Net sales	\$ 1,244,683	\$ 1,402,798	\$ 1,310,159	\$ 1,324,248
Gross margin	431,325	473,814	457,376	423,095
Net income	63,437	80,432	72,383	41,652
Net income per common share <sup>(2)</sup>	\$ 0.37	\$ 0.46	\$ 0.42	\$ 0.25

<sup>(1)</sup> Includes an \$8.4 million cumulative pre-tax charge to correct property tax accruals on leased properties.

<sup>(2)</sup> Figures represent diluted earnings per share.

#### 12. Related Party Transactions:

The Company purchased a variety of merchandise in the ordinary course of business from entities owned or represented by non-employee family members of the Company's former Chairman of the Board and the current Chairman of the Board and Chief Executive Officer. These transactions totaled approximately \$1.2 million, \$1.2 million, and \$17.8 million in fiscal 2005, fiscal 2004 and fiscal 2003, respectively.

#### 13. Subsequent Events

On September 27, 2005, the Company obtained \$250 million in aggregate proceeds through a private placement under Section 4(2) of the Securities Act of 1933, as amended, of unsecured Senior Notes (the "Notes") to a group of institutional accredited investors. The Notes were issued in two tranches at par, and rank *pari passu* in right of payment with the Company's other unsecured senior indebtedness. The first tranche has an aggregate principal amount of \$169 million, is payable in a single installment on September 27, 2015, and bears interest at a rate of 5.41% per annum from the date of issuance. The second tranche has an aggregate principal amount of \$81 million, matures on September 27, 2015, with amortization commencing in the sixth year, and bears interest at a rate of 5.24% per annum from the date of issuance. The second tranche has a required principal repayment of \$16.2 million on September 27, 2011, and on each September 27

thereafter to and including September 27, 2015. Interest on the Notes will be payable semi-annually in arrears on the 27<sup>th</sup> day of March and September of each year commencing on March 27, 2006. The sale of the Notes was effected in transactions not requiring registration under the Securities Act of 1933, as amended.

On October 4, 2005, the Company executed an overnight share repurchase transaction with a bank for the acquisition of 10 million shares, or approximately 6%, of the Company's outstanding Common Stock for an initial purchase price of \$19.97 per share. The transaction was financed with the proceeds of the Company's issuance of \$250 million aggregate principal amount of the Notes. Pursuant to the agreement with the bank, the bank will purchase ten million shares in the open market over the next 3-5 months. At the end of the purchase period, the Company will either receive from or pay to the bank a price adjustment based on the volume weighted average purchase price of the shares acquired compared to the initial purchase price to the bank. Such price adjustment can be either in cash or stock at the discretion of the Company. The Company has limited its potential financial exposure in the event of an increase in its share price above a cap during the purchase period with respect to five million of the repurchased shares.

Subsequent to the Company's fiscal 2005 year end, Hurricane Katrina and Hurricane Rita struck the U.S. Gulf Coast, impacting numerous stores in the afflicted areas. The Company has property insurance that covers most of its property damage. Since the Company's stores are widely dispersed, lost sales due to closed stores are generally limited and are often offset by increased sales in other stores. Therefore, these storms have not had a material impact in the aggregate on the Company's financial position, liquidity or results of operations. The long-term impact of these storms is more difficult to forecast. The potential increase in energy costs over the long-term could negatively impact the Company and its customers. However, the resources received by customers from government and private organizations and the funds contributed in the rebuilding effort, could positively impact sales.

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**ITEM 9A. CONTROLS AND PROCEDURES**

**Disclosure Controls and Procedures**

Based on an evaluation by management of the Company (with the participation of the Company's Chief Executive Officer and Chief Financial Officer), as of the end of the period covered by this report, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, (the "Exchange Act")) were effective to provide reasonable assurance that information required to be disclosed by the Company in reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission ("SEC") rules and forms and that such information is accumulated and communicated to the Company's management, including the Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures. Consistent with the suggestion of the SEC, the Company has formed a Disclosure Committee consisting of key Company personnel designed to review the accuracy and completeness of all disclosures made by the Company.

**Management's Report on Internal Control Over Financial Reporting**

Management is responsible for establishing and maintaining adequate internal control over financial reporting for Family Dollar Stores. 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. Internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) 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 (iii) 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.

Management (with the participation of the principal executive officer and principal financial officer) conducted an evaluation of the effectiveness of the Company's internal control over financial reporting based on the framework in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this evaluation, management concluded that the Company's internal control over financial reporting was effective as of August 27, 2005.

Management's assessment of the effectiveness of the Company's internal control over financial reporting as of August 27, 2005, has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their attestation report which is included under Item 8.

#### **Attestation Report of the Registered Public Accounting Firm**

Included in Item 8.

#### **Changes in Internal Control over Financial Reporting**

There were no changes in the Company's internal control over financial reporting during the Company's fourth fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

#### **ITEM 9B. OTHER INFORMATION**

None

### **PART III**

#### **ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT**

The information required by this item as to the Company's directors, director nominees, audit committee financial expert, audit committee, and procedures for stockholders to recommend director nominees will be included in the Company's proxy statement to be filed for the Annual Meeting of Stockholders to be held on January 19, 2006, under the captions "Election of Directors" and "Corporate Governance Matters and Committees of the Board of Directors" and is incorporated by reference herein. The information required by this item as to compliance by the Company's directors, executive officers and certain beneficial owners of the Company's Common Stock with Section 16(a) of the Securities Exchange Act of 1934 also will be included in said proxy statement under the caption "Section 16(a) Beneficial Ownership Reporting Compliance" and also is incorporated herein by reference. The information required by this item as to executive officers is included in Part I, Item 1 of this Report and also is incorporated herein by reference.

The Company has adopted: (i) a Code of Ethics that applies to the Chief Executive Officer and senior financial officers, including the Chief Financial Officer, the principal accounting officer and the controller; (ii) a Code of Business Conduct that governs the actions of all Company employees, including officers; and (iii) a Board of Directors Code of Business Conduct applicable to all directors (collectively the "Codes of Conduct"). The Codes of Conduct are posted within the Investors section of the Company's Internet Website at [www.familydollar.com](http://www.familydollar.com). The Company will provide a copy of the Codes of Conduct to any stockholder upon request. Any amendments to and/or any waiver from a provision of any of the Codes of Conduct granted to any director, executive officer or any senior financial officer, must be approved by the Board of Directors and will be disclosed on the Company's Internet Website within three business days following the amendment or waiver. The information contained on or connected to the Company's Internet Website is not incorporated by reference into this Form 10-K and should not be considered part of this or any other report that the Company files with or furnishes to the Securities and Exchange Commission.

**ITEM 11. EXECUTIVE COMPENSATION**

The information required by this item will be included in the Company's proxy statement to be filed for the Annual Meeting of Stockholders to be held on January 19, 2006, under the captions "Executive Compensation" and "Compensation of Directors" and is incorporated herein by reference.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required by this item as to security ownership by certain beneficial owners and management will be included in the Company's proxy statement to be filed for the Annual Meeting of Stockholders to be held on January 19, 2006, under the caption "Ownership of the Company's Securities" and is incorporated herein by reference. The information required by this item as to securities authorized for issuance under equity compensation plans also will be included in said proxy statement under the caption "Equity Compensation Plan Information" and also is incorporated herein by reference.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

The information required by this item will be included in the Company's proxy statement to be filed for the Annual Meeting of Stockholders to be held on January 19, 2006, under the caption "Related Transactions" and is incorporated herein by reference.

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information required by this item will be included in the Company's proxy statement to be filed for the Annual Meeting of Stockholders to be held on January 19, 2006, under the caption "Independent Registered Public Accounting Firm's Fees and Services" and is incorporated herein by reference.

**PART IV**

**ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 10-K**

(a) Documents filed as part of this report:

1. Consolidated Financial Statements (See Item 8):
2. All schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are not required under the related instructions, are inapplicable or the information is included in the Consolidated Financial Statements, and therefore, have been omitted.

The Financial Statements of Family Dollar Stores, Inc., (Parent Company) are omitted because the registrant is primarily a holding company and all subsidiaries included in the consolidated financial statements being filed, in the aggregate, do not have minority equity and/or indebtedness to any person other than the registrant or its consolidated subsidiaries in amounts which together exceed 5 percent of the total assets as shown by the most recent year-end consolidated balance sheet.

3. The Exhibits listed below in item (b).

(b) The accompanying Index to Exhibits is incorporated herein by reference.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FAMILY DOLLAR STORES, INC.  
(Registrant)

Date November 2, 2005

By /s/ Howard R. Levine  
Howard R. Levine  
Chairman of the Board  
(Chief Executive Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant and in the capacities and on the date indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Howard R. Levine</u> Howard R. Levine	Chairman of the Board, Chief Executive Officer and Director (Principal Executive Officer)	November 2, 2005
<u>/s/ R. James Kelly</u> R. James Kelly	Vice Chairman and Chief Financial Officer (Principal Financial Officer)	November 2, 2005
<u>/s/ C. Martin Sowers</u> C. Martin Sowers	Senior Vice President-Finance (Principal Accounting Officer)	November 2, 2005
<u>/s/ Mark R. Bernstein</u> Mark R. Bernstein	Director	November 2, 2005
<u>/s/ Sharon Allred Decker</u> Sharon Allred Decker	Director	November 2, 2005
<u>/s/ Edward C. Dolby</u> Edward C. Dolby	Director	November 2, 2005
<u>/s/ Glenn A. Eisenberg</u> Glenn A. Eisenberg	Director	November 2, 2005
<u>/s/ George R. Mahoney, Jr.</u> George R. Mahoney, Jr.	Director	November 2, 2005
<u>/s/ James G. Martin</u> James G. Martin	Director	November 2, 2005

## EXHIBIT INDEX

Exhibits incorporated by reference:

- 3.1.1 Certificate of Incorporation, dated November 24, 1969, (filed as Exhibit 3(a) to the Company's Registration Statement on Form S-1, No. 2-35468)
- 3.1.2 Certificate of Amendment, dated February 2, 1972, of Certificate of Incorporation (filed as Exhibit 3(a)(ii) to the Company's Form 10-K for the year ended August 31, 1980)
- 3.1.3 Certificate of Amendment, dated January 23, 1979, of Certificate of Incorporation (filed as Exhibit 2 to the Company's Form 10-Q for the quarter ended February 28, 1979)
- 3.1.4 Certificate of Amendment, dated January 20, 1983, of Certificate of Incorporation (filed as Exhibit 4(iv) to the Company's Registration Statement on Form S-3, No. 2-85343)
- 3.1.5 Certificate of Amendment, dated January 16, 1986, of Certificate of Incorporation (filed as Exhibit 3(a)(v) to the Company's Form 10-K for the year ended August 31, 1986)
- 3.1.6 Certificate of Amendment, dated January 15, 1987, of Certificate of Incorporation (filed as Exhibit 3(a)(vi) to the Company's Form 10-K for the year ended August 31, 1987)
- 3.1.7 Certificate of Amendment, dated January 15, 1998, of Certificate of Incorporation (filed as Exhibit 3.1 to the Company's Registration Statement on Form S-8, No. 333-48751)
- 3.1.8 Certificate of Amendment, dated January 17, 2002, of Certificate of Incorporation filed as Exhibit 3(i) to the Company's Form 10-Q for the quarter ended March 2, 2002)
- 3.2 Bylaws, as amended on August 17, 2004 (filed as Exhibit 3(ii) to the Company Form 10-K filing for the fiscal year ended August 28, 2004)
- 4.1 Sections FOURTH, SIXTH and SEVENTH of the Company's Certificate of Incorporation and all Amendments thereto (included as Exhibits 3.1.1 – 3.1.8) and Articles II, VII, VIII, XII and XIV of the Company's Bylaws (included as Exhibit 3.2)
- \* 10.1 Family Dollar Employee Savings and Retirement Plan and Trust, amended and restated as of January 1, 2002 (filed as Exhibit 10 (iii) to the Company's Form 10-Q for the quarter ended March 2, 2002)
- 10.2 Amended and Restated Credit Agreement, dated as of May 31, 2001, between the Company and Family Dollar, Inc., as Borrower, and Bank of America, N.A. (filed as Exhibit 10 to the Company's Form 10-Q for the quarter ended June 2, 2001)
- 10.3 Amendment dated as of May 29, 2003, between the Company and Family Dollar, Inc., as Borrower, and Bank of America, N.A., amending the Amended and Restated Credit Agreement dated as of May 31, 2001 (filed as Exhibit 10(i) to the Company's Form 10-Q for the quarter ended May 31, 2003)
- 10.4 Second Amendment dated as of May 27, 2004, between the Company and Family Dollar, Inc., as Borrower, and Bank of America, N.A., amending the Amended and Restated Credit Agreement dated as of May 31, 2001 (filed as Exhibit 10(a) to the Company's Report on Form 8-K filed May 27, 2004)
- 10.5 Credit Agreement, dated as of August 7, 2001, between the Company and Family Dollar, Inc., as Borrower, and First Union National Bank (filed as Exhibit 10(i) to the Company's Form 10-K for the year ended September 1, 2001)
- 10.6 First Amendment dated as of May 29, 2003, between the Company and Family Dollar, Inc., as Borrower, and Wachovia Bank, N.A., amending the Credit Agreement dated as of August 7, 2001 (filed as Exhibit 10(ii) to the Company's Form 10-Q for the quarter ended May 31, 2003)

- 10.7 Second Amendment dated as of May 27, 2004, between the Company and Family Dollar, Inc., as Borrower, and Wachovia Bank, N.A., amending the Credit Agreement dated as of August 7, 2001 (filed as Exhibit 10(b) to the Company's Report on Form 8-K filed May 27, 2004.)
- 10.8 Third Amendment to Amended and Restated Credit Agreement between the Company and Family Dollar, Inc., as Borrower, and Bank of America, N.A., dated as of May 16, 2005 (filed as Exhibit 10(a) to the Company's Report on Form 8-K filed May 17, 2005)
- 10.9 Third Amendment to Credit Agreement between the Company and Family Dollar, Inc., as Borrower, and Wachovia Bank, National Association, dated as of May 16, 2005 (filed as Exhibit 10(b) to the Company's Report on Form 8-K filed May 17, 2005)
- \* 10.10 Amendment dated August 29, 2004, to the Employment Agreement dated August 25, 2000, as amended, between the Company and R. David Alexander, Jr. (filed as Exhibit 10(iv) to the Company's Form 10-K for the year ended August 28, 2004)
- \* 10.11 Retirement Agreement dated September 30, 2002, between the Company and Leon Levine (filed as Exhibit 10 to the Company's Report on Form 8-K filed October 2, 2002)
- \* 10.12 Family Dollar 2000 Outside Directors Plan, as amended as of November 5, 2003 (filed as Exhibit 10(iv) to the Company's Form 10-K for the year ended August 30, 2003)
- 10.13 Enhanced Overnight Share Repurchase Agreement dated October 3, 2005, between Family Dollar Stores, Inc., and Bank of America, N.A. (filed as Exhibit 10 to the Company's Report on Form 8-K filed October 4, 2005)
- \* 10.14 Employment Agreement dated August 18, 2005, between the Company and Howard R. Levine (filed as Exhibit 10.2 to the Company's Report on Form 8-K filed August 24, 2005)
- \* 10.15 Employment Agreement dated August 18, 2005, between the Company and R. James Kelly (filed as Exhibit 10.3 to the Company's Report on Form 8-K filed August 24, 2005)
- \* 10.16 Incentive Profit Sharing Plan, amended as of January 17, 2002 (filed as Exhibit 10(i) to the Company's Form 10-K for the year ended August 28, 2004)
- \* 10.17 Medical Expense Reimbursement Plan amended as of November 2, 2004 (filed as Exhibit 10(v) to the Company's Form 10-K for the year ended August 28, 2004)
- \* 10.18 Family Dollar Stores, Inc., 1989 Non-Qualified Stock Option Plan, amended as of August 17, 2004 (filed as Exhibit 10(i) to the Company's Report on Form 8-K filed January 21, 2005)
- \* 10.19 Resolution of the Board of Directors of Family Dollar Stores, Inc., adopted January 20, 2005, regarding compensation of the Directors (filed as Exhibit 10.2 to the Company's Report on Form 8-K filed January 21, 2005)
- \* 10.20 Resolution of the Board of Directors of Family Dollar Stores, Inc., adopted August 18, 2005, regarding compensation of the Company's Lead Director (filed as Exhibit 10.1 to the Company's Report on Form 8-K filed August 24, 2005)
- \* 10.21 2006 Incentive Plan Guidelines for Long Term Incentive Performance Share Rights Awards (filed as Exhibit 10.1 to the Company's Report on Form 8-K filed September 29, 2005)
- \* 10.22 Form of Performance Share Rights Award Certificate Awards (filed as Exhibit 10.2 to the Company's Report on Form 8-K filed September 29, 2005)
- \* 10.23 Letter Agreement dated August 2, 2005, by and between Family Dollar Stores, Inc., and R. David Alexander, Jr. (filed as Exhibit 10 to the Company's Report on Form 8-K filed August 5, 2005)

14 Code of Ethics for Chief Executive and Senior Financial Officers (filed as Exhibit 14 to the Company's Form 10-K for the year ended August 30, 2003)

Exhibits filed herewith:

- 4.2 Form of certificate representing shares of the Company's Common Stock
- 10.24 Note Purchase Agreement dated as of September 27, 2005, between Family Dollar Stores, Inc., Family Dollar, Inc., and the various purchasers named therein, relating to \$169,000,000 5.41% Series 2005-A Senior Notes, Tranche A, due September 27, 2015; and, \$81,000,000 5.24% Series 2005-A Senior Notes, Tranche B, due September 27, 2015
- \* 10.25 Summary of Family Dollar Stores, Inc., Executive Supplemental Disability Income Plan
- \* 10.26 Family Dollar Stores, Inc., Executive Life Plan
- \* 10.27 Relocation Policy applicable to executive officers of the Company
- \* 10.28 Letter agreement between the Company and Irving Neger dated July 21, 2000
- \* 10.29 Separation agreement between the Company and Irving Neger dated November 1, 2005
- \* 10.30 Summary of compensation arrangements of the Company's named executive officers
- \* 10.31 Letter agreement between the Company and Robert A. George dated July 19, 2005
- \* 10.32 Employment Agreement dated November 4, 2005, between the Company and Charles S. Gibson, Jr.
- \* 10.33 Amended and Restated Family Dollar Compensation Deferral Plan
- 21 Subsidiaries of the Company
- 23 Consent dated November 7, 2005, of PricewaterhouseCoopers LLP, independent registered public accounting firm
- 31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of Chief Executive Officer
- 31.2 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of Chief Financial Officer
- 32.1 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of Chief Executive Officer
- 32.2 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of Chief Financial Officer

---

\* Exhibit represents a management contract or compensatory plan



**FAMILY DOLLAR STORES, INC.**  
**Listing of Active Corporations and other Entities**

<u>Entity</u>	<u>State of Incorporation/ Organization</u>
Family Dollar Stores, Inc.	Delaware
Family Dollar, Inc.	North Carolina
Family Dollar Holdings, Inc.	North Carolina
Family Dollar Services, Inc.	North Carolina
Family Dollar Operations, Inc.	North Carolina
Family Dollar Trucking, Inc.	North Carolina
Family Dollar Merchandising, L.P.	Delaware
Family Dollar Distribution, L.P.	Texas
Family Dollar Stores of Alabama, Inc.	Alabama
Family Dollar Stores of Arkansas, Inc.	Arkansas
Family Dollar Stores of Colorado, Inc.	Colorado
Family Dollar Stores of Connecticut, Inc.	Connecticut
Family Dollar Stores of Delaware, Inc.	Delaware
Family Dollar Stores of D.C., Inc.	District of Columbia
Family Dollar Stores of Florida, Inc.	Florida
Family Dollar Stores of Georgia, Inc.	Georgia
Family Dollar Stores of Indiana, L.P.	Indiana
Family Dollar Stores of Iowa, Inc.	Iowa
Family Dollar Stores of Kentucky, Ltd.	Kentucky
Family Dollar Stores of Louisiana, Inc.	Louisiana
Family Dollar Stores of Maryland, Inc.	Maryland
Family Dollar Stores of Massachusetts, Inc.	Massachusetts
Family Dollar Stores of Michigan, Inc.	Michigan
Family Dollar Stores of Mississippi, Inc.	Mississippi
Family Dollar Stores of Missouri, Inc.	Missouri
Family Dollar Stores of New Jersey, Inc.	New Jersey
Family Dollar Stores of New Mexico, Inc.	New Mexico
Family Dollar Stores of New York, Inc.	New York
Family Dollar Stores of North Carolina, Inc.	North Carolina
Family Dollar Stores of Ohio, Inc.	Ohio
Family Dollar Stores of Oklahoma, Inc.	Oklahoma
Family Dollar Stores of Pennsylvania, Inc.	Pennsylvania
Family Dollar Stores of Rhode Island, Inc.	Rhode Island
Family Dollar Stores of South Carolina, Inc.	South Carolina
Family Dollar Stores of South Dakota, Inc.	South Dakota
Family Dollar Stores of Tennessee, Inc.	Tennessee
Family Dollar Stores of Texas, L.P.	Texas
Family Dollar Stores of Vermont, Inc.	Vermont
Family Dollar Stores of Virginia, Inc.	Virginia
Family Dollar Stores of West Virginia, Inc.	West Virginia
Family Dollar Stores of Wisconsin, Inc.	Wisconsin

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (File Number 333-122201 and File Number 333-105005) of Family Dollar Stores, Inc., of our report dated November 2, 2005, relating to the financial statements, management's assessment of the effectiveness of internal control over financial reporting and the effectiveness of internal control over financial reporting, which appears in the Annual Report to Shareholders, which is incorporated in this Annual Report on Form 10 K.

PricewaterhouseCoopers LLP  
Charlotte, North Carolina  
November 7, 2005

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER  
PURSUANT TO RULES 13a-14(a) AND 15d-14(a)  
UNDER THE SECURITIES EXCHANGE ACT OF 1934,  
AS ADOPTED PURSUANT TO SECTION 302  
OF THE SARBANES-OXLEY ACT OF 2002**

I, Howard R. Levine, certify that:

1. I have reviewed this annual report on Form 10-K of Family Dollar Stores, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
  - (a) Designed such disclosure controls and procedures or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 7, 2005

/s/ Howard R. Levine

Howard R. Levine  
Chairman of the Board and Chief Executive Officer  
(Principal Executive Officer)

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER  
PURSUANT TO RULES 13a-14(a) AND 15d-14(a)  
UNDER THE SECURITIES EXCHANGE ACT OF 1934,  
AS ADOPTED PURSUANT TO SECTION 302  
OF THE SARBANES-OXLEY ACT OF 2002**

I, R. James Kelly, certify that:

1. I have reviewed this annual report on Form 10-K of Family Dollar Stores, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
  - (a) Designed such disclosure controls and procedures or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 7, 2005

/s/ R. James Kelly

R. James Kelly  
Vice Chairman and Chief Financial Officer  
(Principal Financial Officer)

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER  
PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO SECTION 906  
OF THE SARBANES-OXLEY ACT OF 2002**

I, Howard R. Levine, Chairman of the Board and Chief Executive Officer of Family Dollar Stores, Inc., (the "Company"), do hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

- the Annual Report on Form 10-K of the Company for the year ended August 27, 2005, as filed with the Securities and Exchange Commission (the "Report"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 7, 2005

/s/ Howard R. Levine

Howard R. Levine  
Chairman of the Board and Chief Executive Officer  
(Principal Executive Officer)

A signed original of this written statement required by Section 906 has been provided to Family Dollar Stores, Inc., and will be retained by Family Dollar Stores, Inc., and furnished to the Securities and Exchange Commission or its staff upon request.

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER  
PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO SECTION 906  
OF THE SARBANES-OXLEY ACT OF 2002**

I, R. James Kelly, Vice Chairman and Chief Financial Officer of Family Dollar Stores, Inc., (the "Company"), do hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

- the Annual Report on Form 10-K of the Company for the year ended August 27, 2005, as filed with the Securities and Exchange Commission (the "Report"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 7, 2005

/s/ R. James Kelly  
\_\_\_\_\_  
R. James Kelly  
Vice Chairman and Chief Financial Officer  
(Principal Financial Officer)

A signed original of this written statement required by Section 906 has been provided to Family Dollar Stores, Inc., and will be retained by Family Dollar Stores, Inc., and furnished to the Securities and Exchange Commission or its staff upon request.

Intentionally Left Blank

Intentionally Left Blank