

All in the Family

May 25, 2011



Pershing Square Capital Management, L.P.

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Funds managed by Pershing Square and its affiliates have invested in common stock of Family Dollar Stores Inc. ("FDO"). Pershing Square manages funds that are in the business of trading – buying and selling – securities and financial instruments. It is possible that there will be developments in the future that cause Pershing Square to change its position regarding FDO. Pershing Square may buy, sell, cover or otherwise change the form of its investment in FDO for any reason. Pershing Square hereby disclaims any duty to provide any updates or changes to the analyses contained here including, without limitation, the manner or type of any Pershing Square investment.

Family Dollar



Ticker:
FDO

Stock Price:
\$54

Market Cap:
~\$6.6B

EV:
~\$6.7B

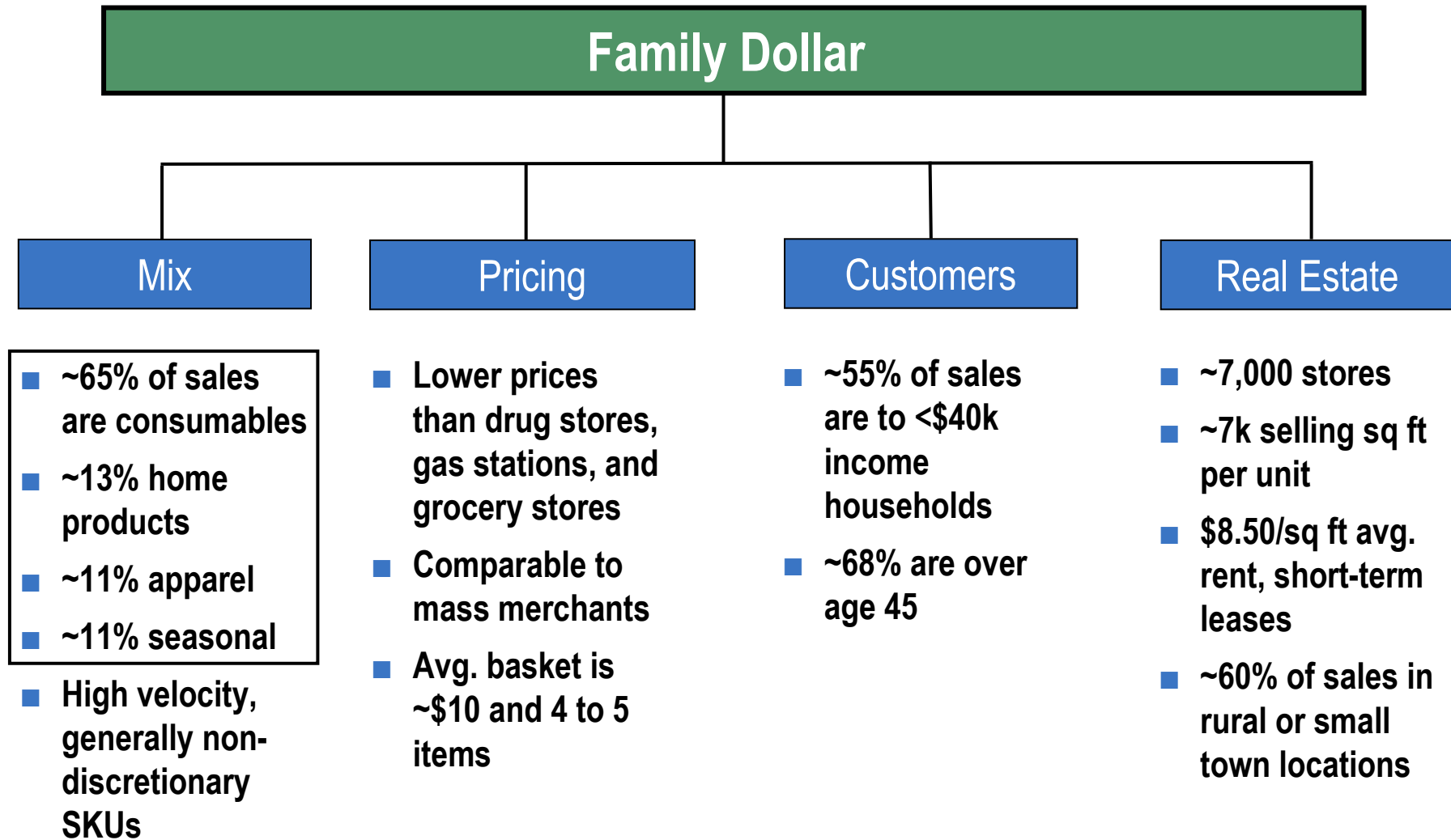
FY2012 P/E¹:
14x
(August FY)



Note: ¹Pershing Square EPS estimate of \$3.88
All stock prices and financials are as of May 24, 2011 close

Business Overview

Business Description



Value Proposition: Price and Convenience

Dollar stores offer pricing comparable to Wal-Mart in a more convenient format. Lower income customers use dollar stores as weekly fill-in trips between supercenter destination shopping. The average FDO store visit is 8 minutes

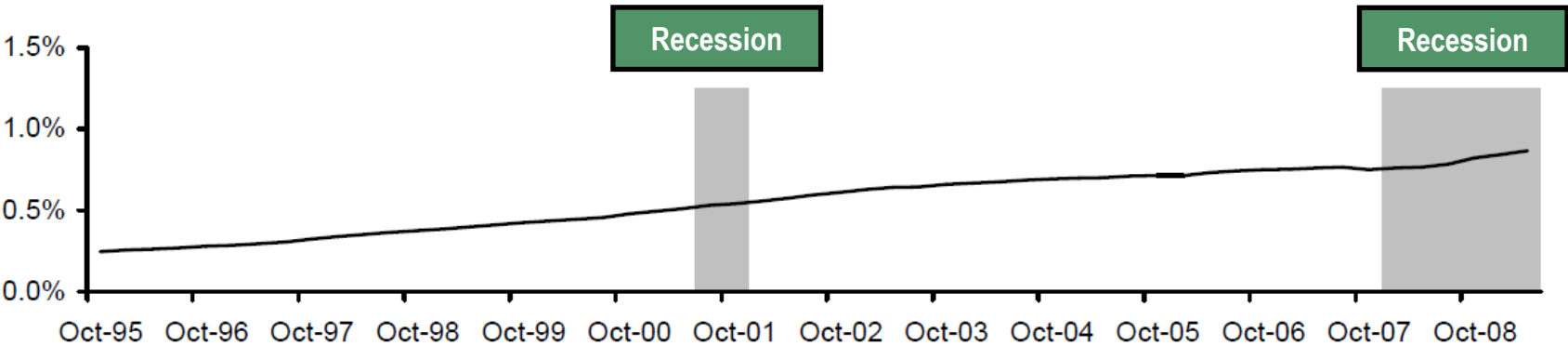
Concept	Price Index	Store Size ('000)
Dollar Stores	100	7
Drug Stores	~120	40
Grocers	~115	40
Mass Merchants	~95	125

Wal-Mart and dollar stores can coexist. Management believes FDO has ~3% share of their core customer's wallet compared to WMT's ~35% share

Share Gain in Retail

High unit and same store sales growth have led to significant share gains for the dollar store channel

Public Dollar Stores Share of Core Retail Sales (Rolling 4Q Avg.)

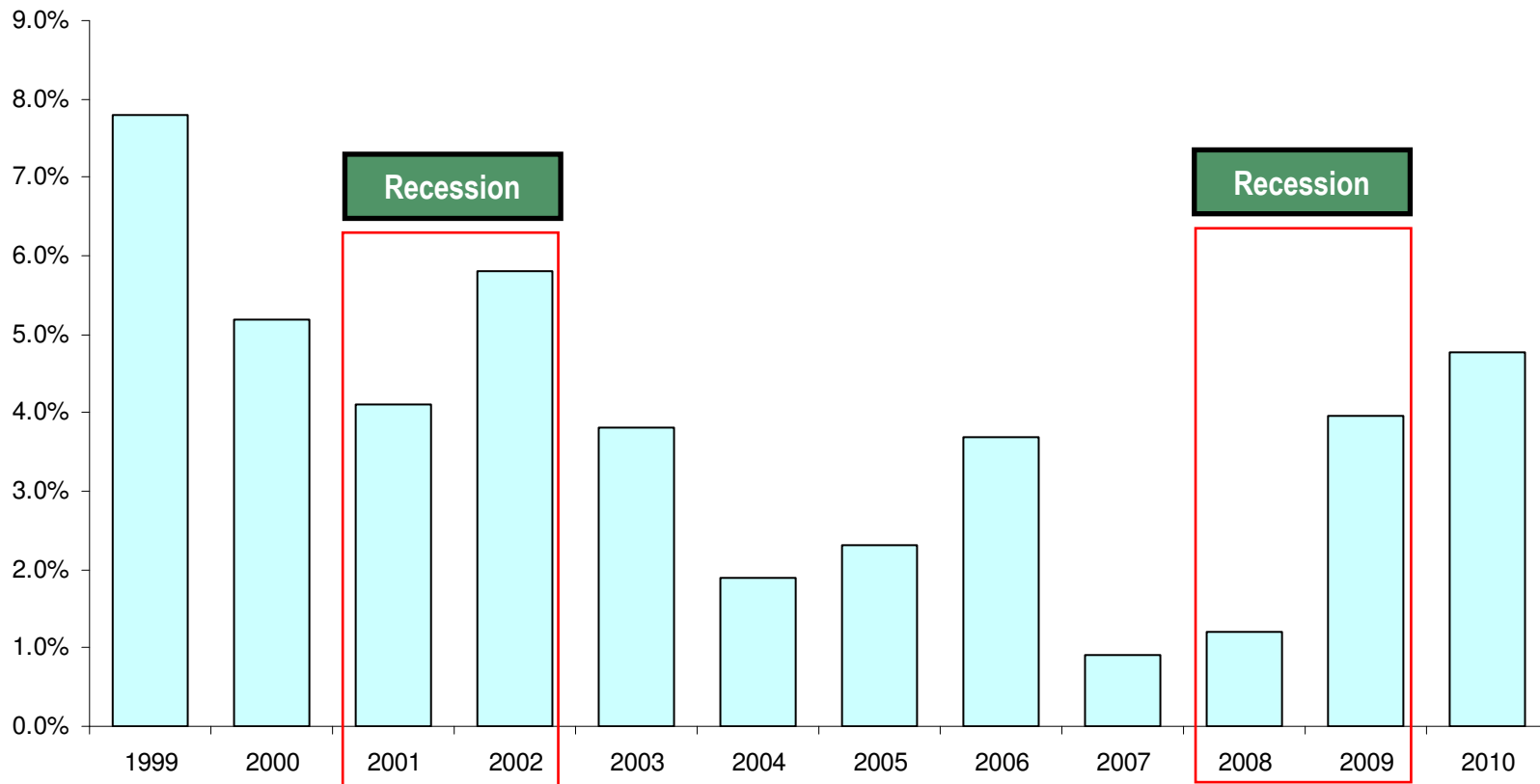


Source: Bernstein, 2009

Consistent Same Store Sales Growth

Family Dollar, like other dollar store retailers, has consistently grown SSS over the last decade even during recessions

Same Store Sales Growth

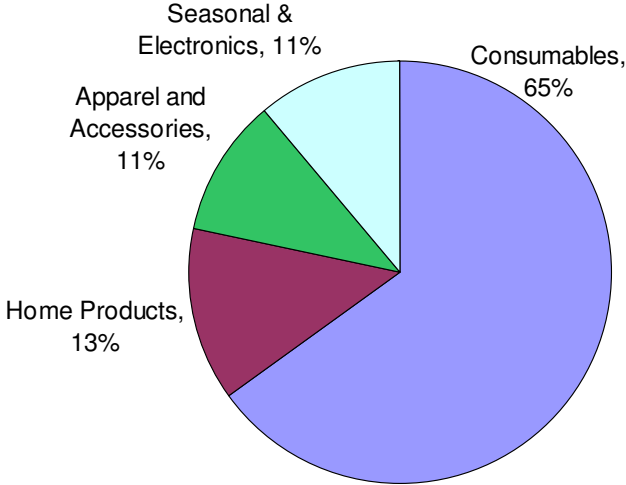


Note: Years are Fiscal Year Ending August

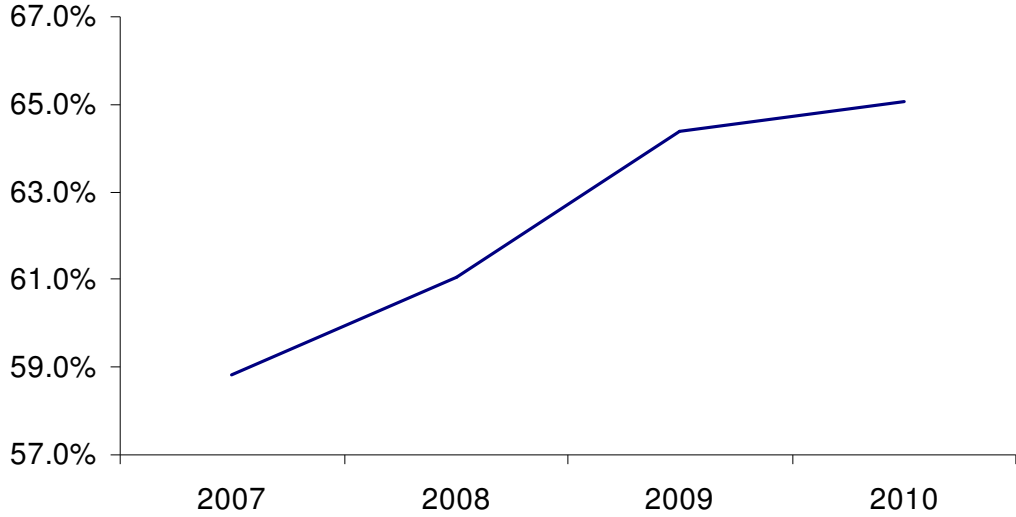
Sales Mix

Consumables make up a growing percentage of Family Dollar's sales volume. Growth in consumables is responsible for most of FDO's recent traffic and same-store sales growth

Sales by Category

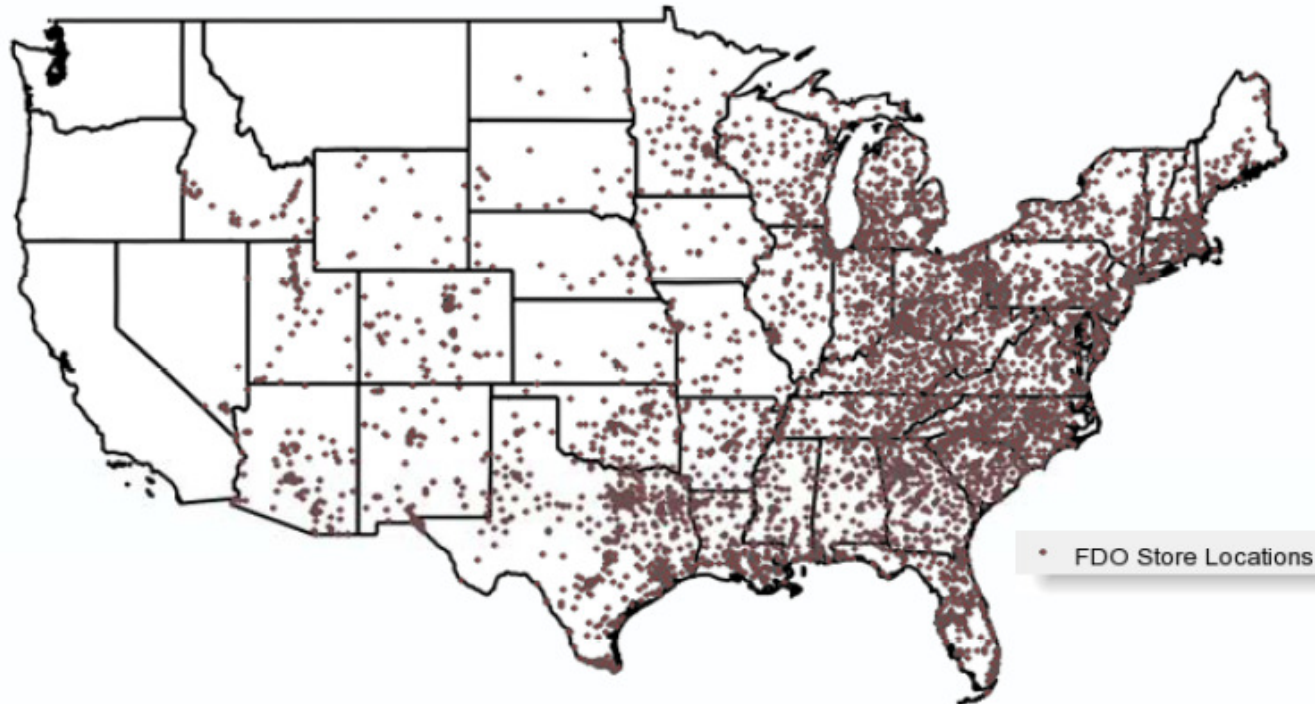


Consumables Sales Mix



Substantial Long-Term Growth Opportunity

The three major dollar store retail chains (Family Dollar, Dollar General, Dollar Tree) operate ~20k units today. We believe there is room for 10k to 12k additional stores¹ or a decade of store growth at the current industry build rate

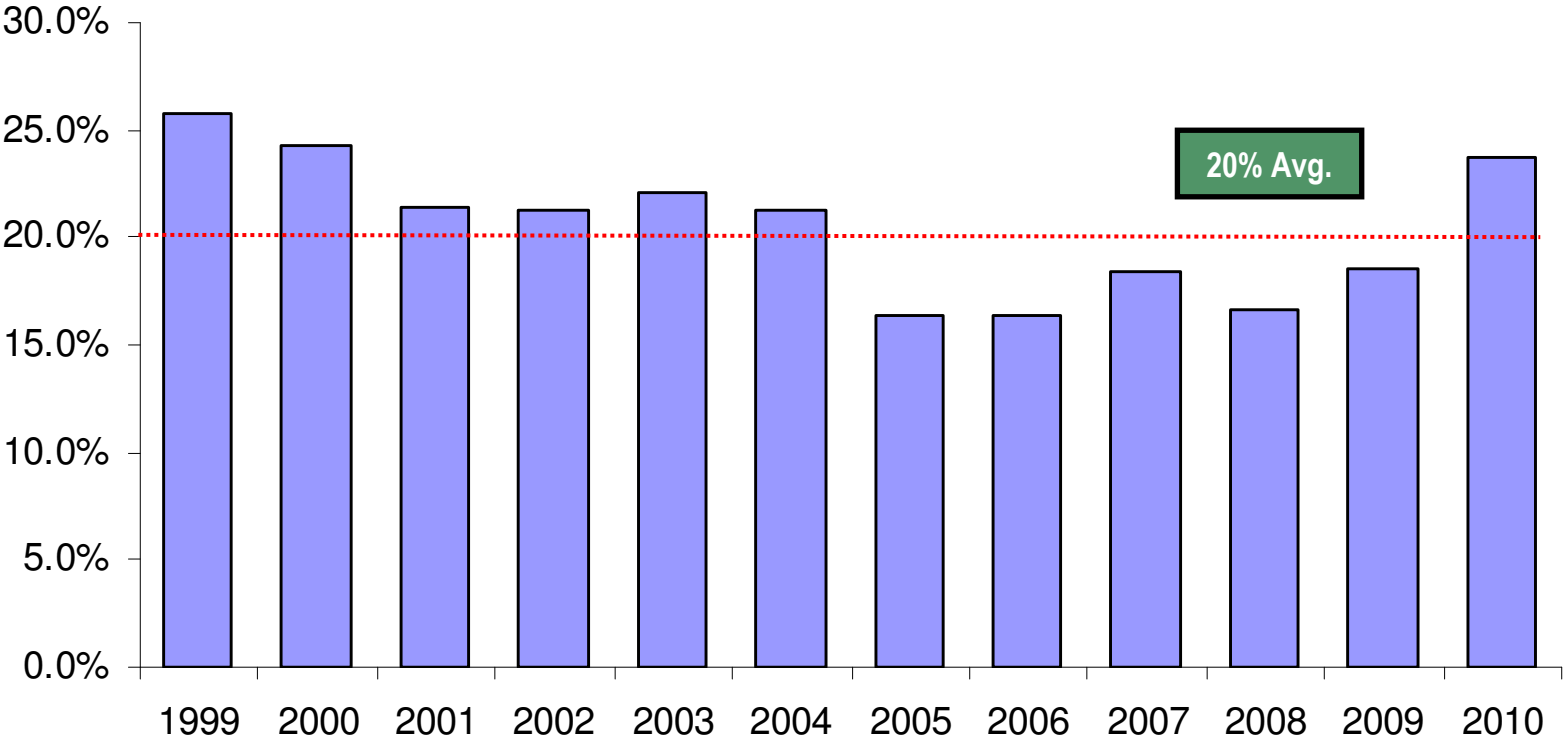


High Rates of Return on Capital

Historical Returns on Capital

Family Dollar has a strong track record of earning high returns on capital

Percent Return on Capital (without capitalizing leases)



Note: Years are Fiscal Year Ending August
ROIC Defined as: (Taxed EBIT)/Average (Assets - Cash - A/P - Accrued Expenses)

Shareholder-Oriented Capital Allocation Strategy

In FY2011, Family Dollar plans to invest \$300-\$350mm of capex and repurchase nearly \$750mm of stock

- ▶ **New Store Growth (~\$60mm Capex, ~\$15mm SG&A):**
 - 300 new store openings and 80-100 store closings, 3% net growth
 - Long-term, management expects to grow store count 5-7% annually

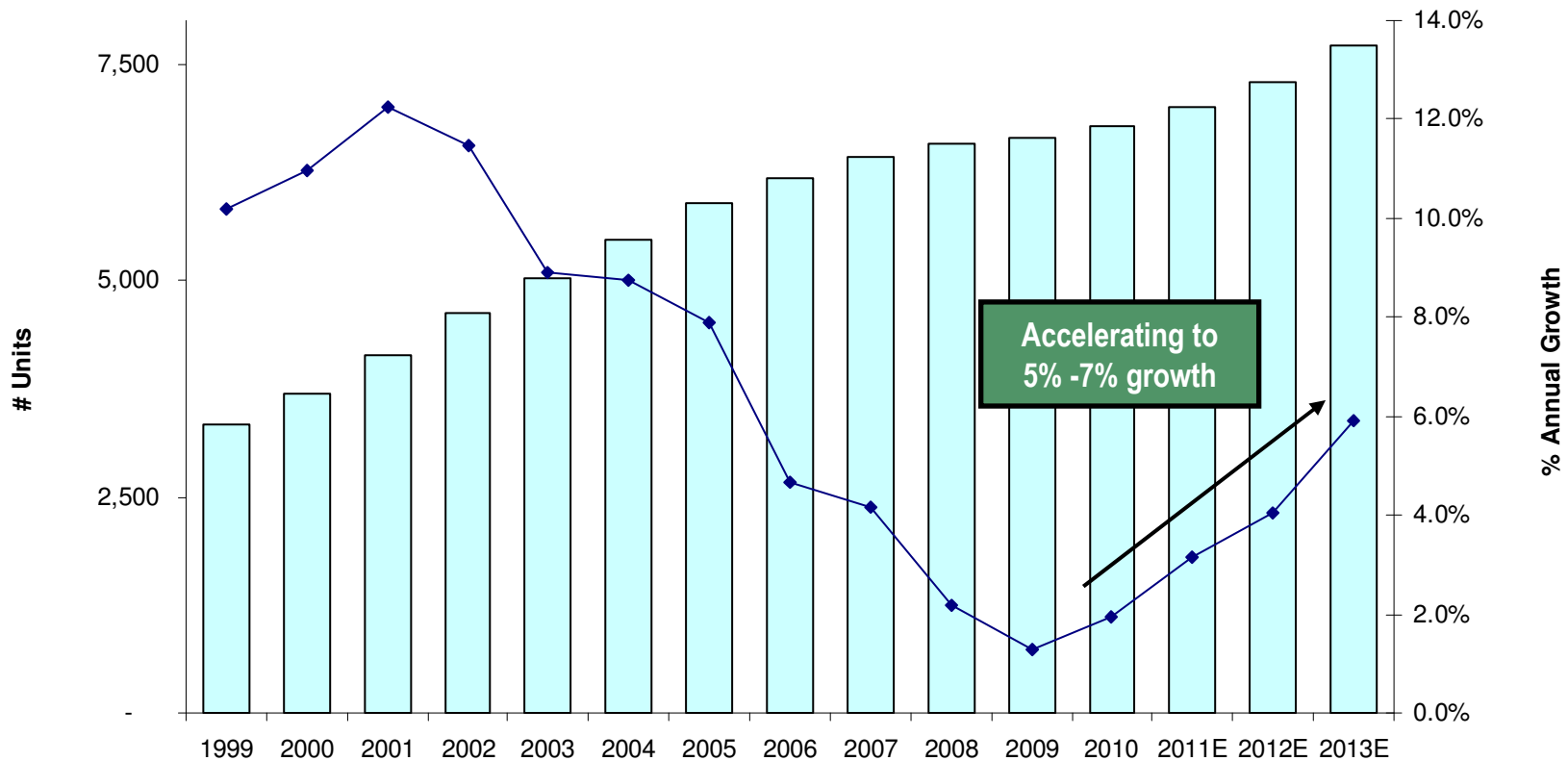
- ▶ **Store Renovation Program (~\$60mm Capex, ~\$30mm SG&A):**
 - Over 800 stores in FY2011
 - Going forward, management expects to renovate 1,000+ stores per year

- ▶ **Share Repurchases & Dividends:**
 - Management has committed to buyback \$750mm of shares by fall 2011
 - FDO raised its dividend this year to \$.72/share (\$85mm)

New Unit Growth

New unit growth is accelerating after a pause that allowed management to refocus on improving core operations. Management now believes that with the current model FDO can grow units 5-7% per year by FY2013

Ending Unit Count



Note: Years are Fiscal Year Ending August

New Unit Economics

New units are generally inexpensive to build and highly profitable. On average, units are 90% productive in their first year

Estimated New Store Investment

Capex	\$ 200,000
SG&A	50,000
Inventory, net	75,000
Estimated Investment	\$ 325,000

New Store Earnings

	Low	High
Mature Revenue	\$1,200,000	\$1,200,000
Estimated Mature 4-wall EBIT Margin	10.00%	15.00%
Estimated EBIT	\$ 120,000	\$ 180,000

% Pre-Tax Return	37%	55%
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High Return on Renovation Capital

Management began an ambitious renovation program this year. While the company has not disclosed detailed data, it has revealed that renovated stores achieve at least a 10% sales lift

Renovation ROIC Estimate

Capex	\$ 77,000
SG&A	38,000
Estimated Investment	\$ 115,000

	Low	Mid	High
Base Store Sales	\$ 1,200,000	\$ 1,200,000	\$ 1,200,000
Sales Lift %	10.00%	12.50%	15.00%
Incremental Gross Margin	30.00%	30.00%	30.00%
Estimated Incremental EBIT	36,000	45,000	54,000

Lower than company average (35.7%) to account for increased consumables mix



% Pre-Tax Return	31%	39%	47%
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FDO plans to renovate 6,000 stores

Productivity Opportunity

Family Dollar vs. Dollar General

In many ways, Family Dollar and Dollar General are very similar companies:

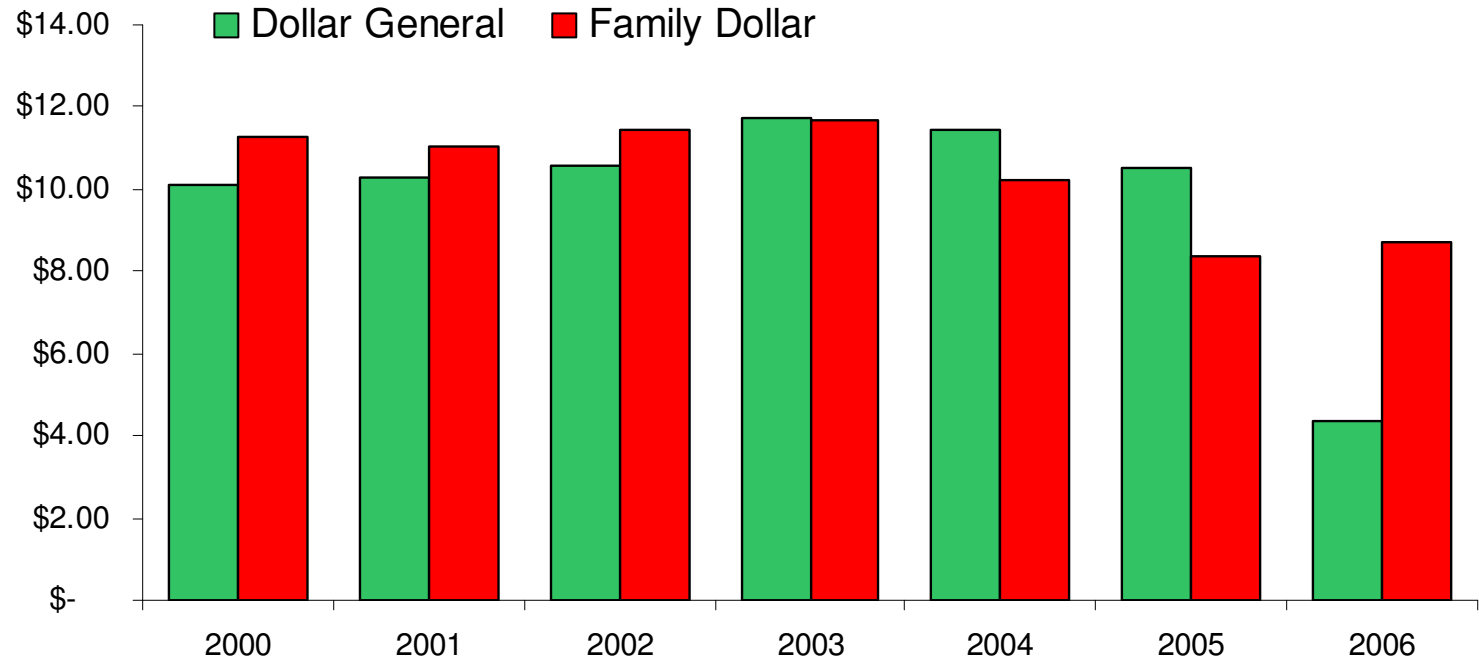
		
✓ Number of Stores	~7,000	~9,500
✓ Sales per Store	~\$1.2mm	~\$1.4mm
✓ Size of Average Store	~7k sqft	~7k sqft
✓ Consumables Mix	65%	72%
✓ Properties	Leased, Mostly rural & suburban	Leased, Mostly rural & suburban

Despite these similarities, the two business' performance has diverged...

Family Dollar vs. Dollar General (Cont.)

For many years, the two companies had very similar performance:

EBIT per square foot

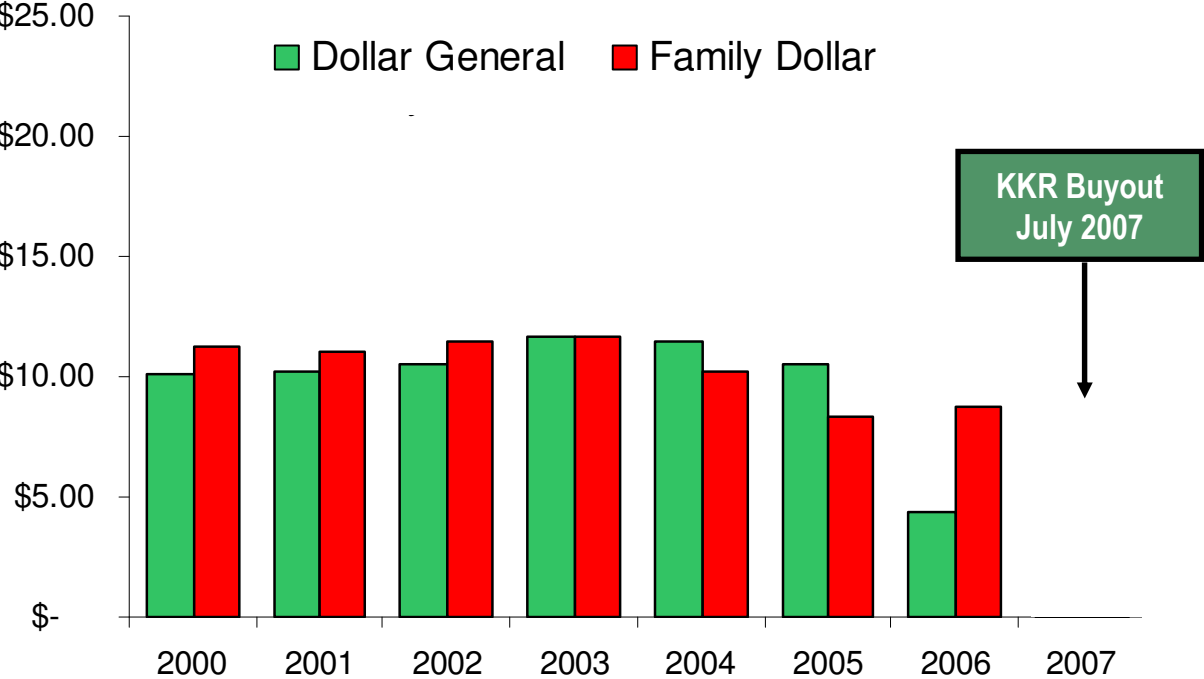


Note: Family Dollar results are calendarized to year end Feb.

Family Dollar vs. Dollar General (Cont.)

In July 2007, KKR bought Dollar General. Less than four years later, let's compare the two companies:

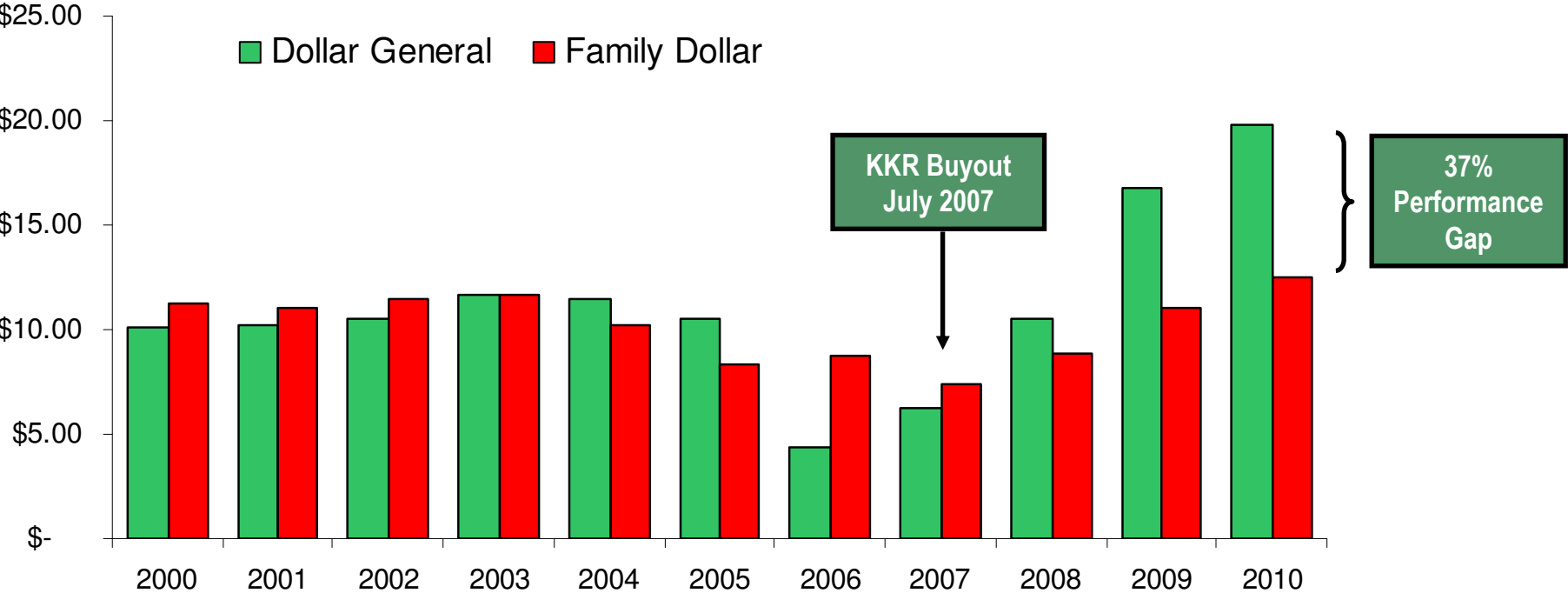
EBIT per square foot



Note: Family Dollar results are calendarized to year end Feb.

And the Winner is: Dollar General

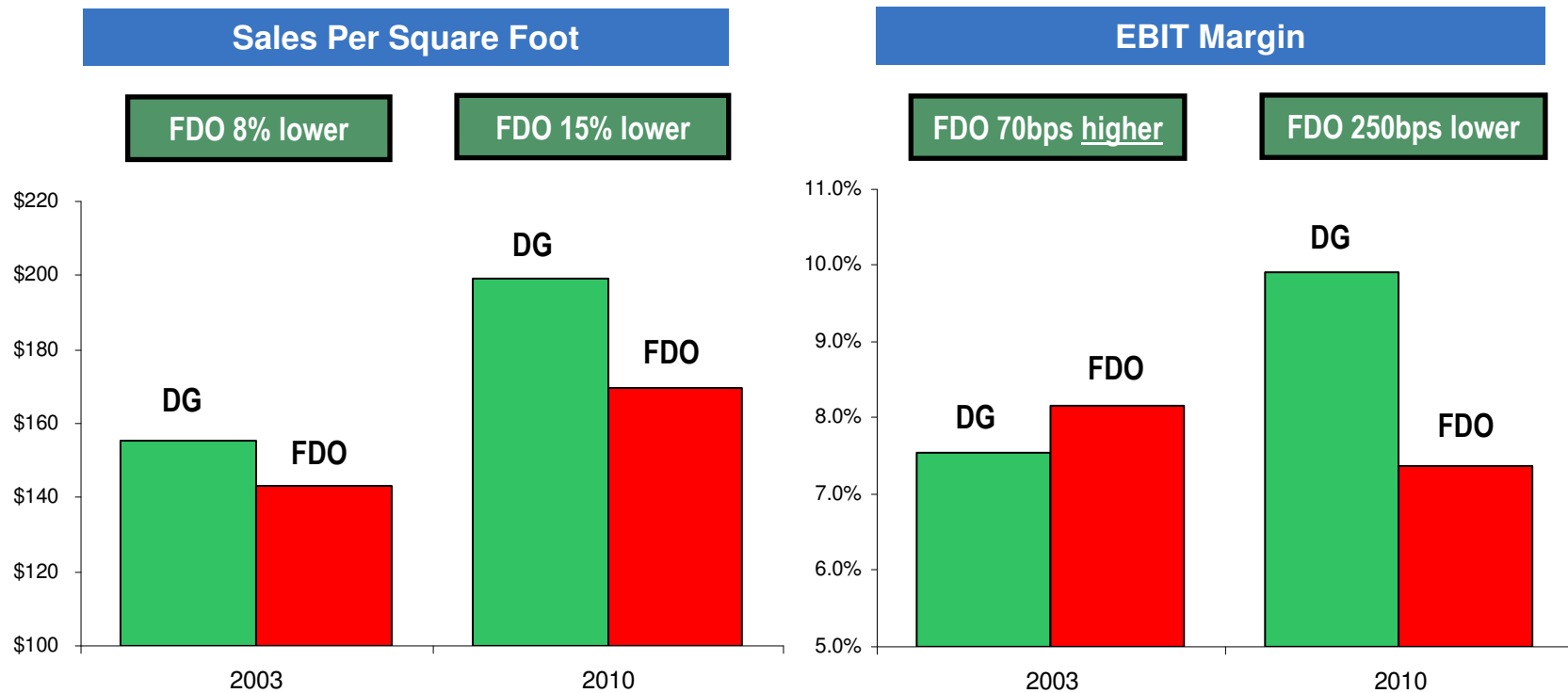
EBIT per square foot



Note: Family Dollar results are calendarized to year end Feb.

Productivity Gap

Family Dollar's lower profitability is a result of both lower sales per square foot growth and lower margins

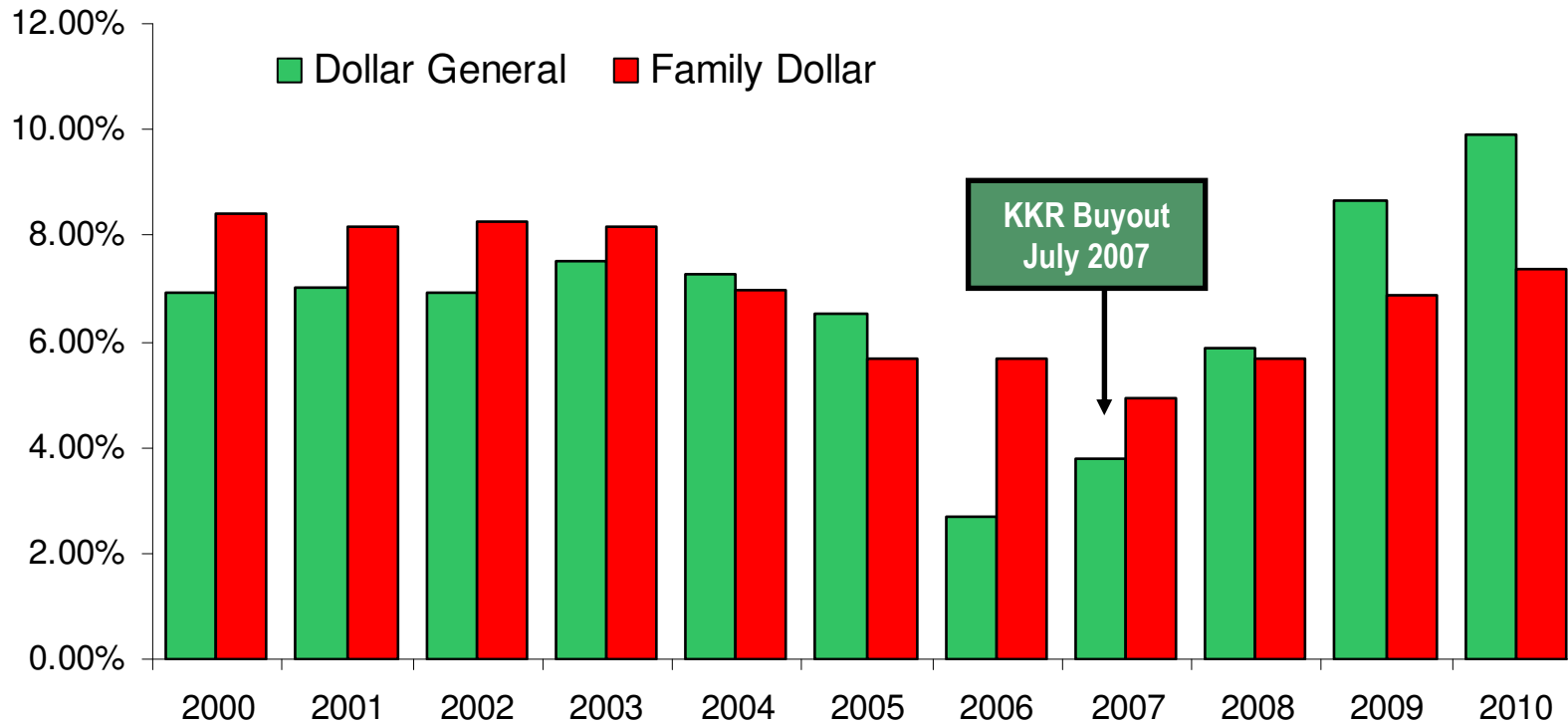


Note: 2003 Family Dollar results are calendarized year end Feb. 2004

Relative Margin Trends

Under KKR's ownership, Dollar General has dramatically improved margins

EBIT Margin

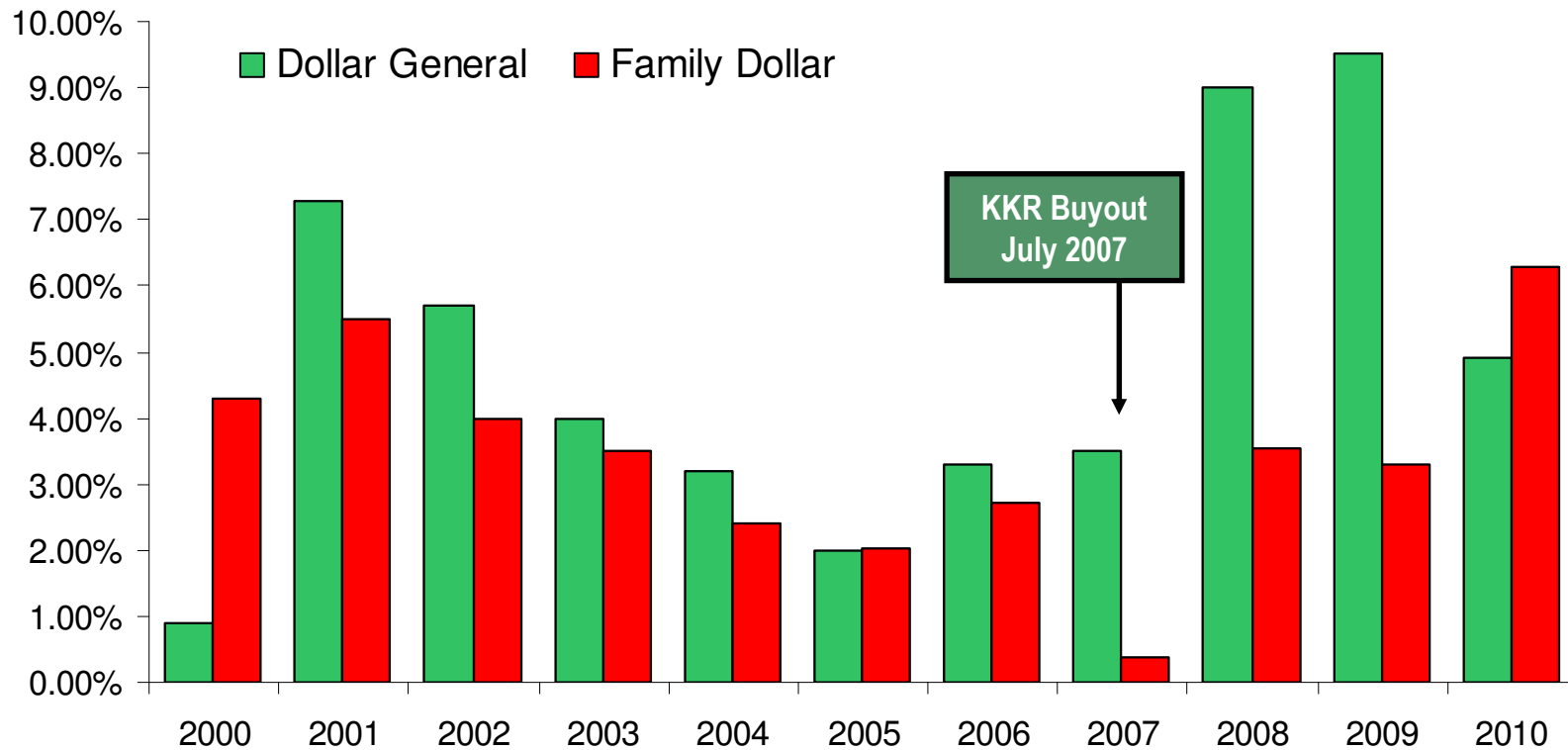


Note: Family Dollar results are calendarized to year end Feb.

Relative Sales Trends

After years of similar SSS results, since the KKR deal, Dollar General has grown at a much faster rate than Family Dollar

Same Store Sales



Note: Family Dollar results are calendarized to year end Feb.

Dollar General Post KKR

**Despite similar sales mix, geography, unit count, and store size:
Dollar General has -**

- ✓ Higher sales per square foot**
- ✓ Higher margins**
- ✓ Faster profit growth**

**Management is Working to
Close the Gap**

FDO is Playing Catch Up

FDO has launched gross margin enhancement initiatives that are similar to the ones DG has successfully implemented

▶ **Private Label Penetration**

- Dollar General's consumable private label penetration is ~22%
- Family Dollar's consumable private label penetration is ~14%
- Family Dollar's goal is to get to 20%

▶ **Global Sourcing**

- Bypassing a broker and directly sourcing unlabeled and private labeled goods can offer 1,000bps to 1,500bps of margin improvement
- Currently, only 9% of FDO's goods are directly imported. We believe this number could approach 15% in the future

▶ **Improved Pricing**

- FDO recently implemented sophisticated pricing software allowing management to better manage regional pricing zones and elasticity data

▶ **Reduced Shrink**

FDO is Playing Catch Up (cont).

We estimate FDO will benefit significantly from its gross margin initiatives

Estimated Gap		
	2010	Potential
Global Sourcing	9%	15%
Private Label - Consumables	14%	20%

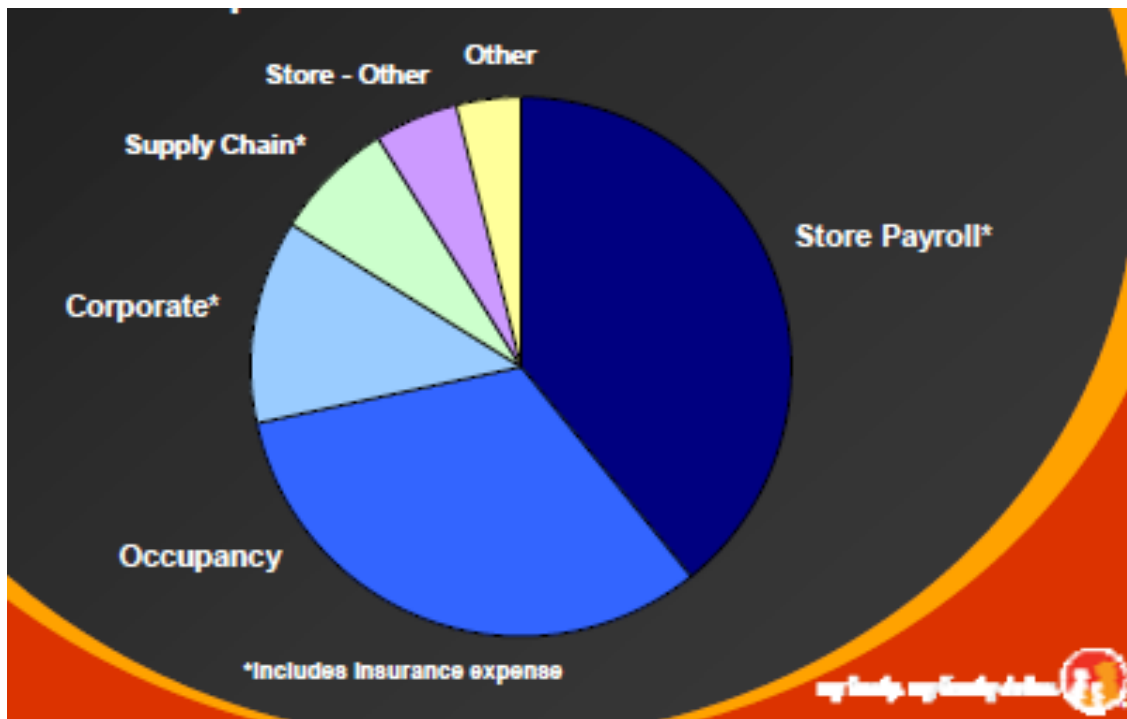
Estimated Margin Improvement			
	% of Sales	Delta	Total
Global Sourcing	6%	1250 bps	75 bps
Private Label - Consumables	4%	1250 bps	50 bps
Shrink, Pricing			100 bps
Offsets - Private label reinvestment, inflation, mix			?
Total			<225 bps

FDO's substantial gross margin opportunity and high percentage of sales in low-priced necessities, provide a margin of safety against commodities inflation

SG&A: Highly Leverageable

Two thirds of Family Dollar's SG&A expense is composed of occupancy and store payroll costs, which are highly leverageable. Management believes core SG&A costs, excluding growth initiatives, will grow modestly at 2 to 3% per year

SG&A Composition (FY 2009)



← SG&A includes ~\$45mm (~50bps of sales) of renovation and new store pre-opening expense

Sales Growth Opportunity

Family Dollar has several initiatives in place to support management's 4-6% medium-term SSS growth guidance

- ▶ **Expanded hours**
 - FDO completed its expanded hours rollout Q2 FY2010

- ▶ **New store growth and renovations**
 - Could contribute 1.5% to 2.0% SSS at the current build rate
 - New stores can contribute a ~10% comp in the second year
 - Renovated stores are growing SSS at a double digit rate

- ▶ **New fixtures to support continued consumables growth**
 - FDO's consumable mix trails DG by ~700bps

- ▶ **Managing to lower stock outs**

- ▶ **Improved marketing**

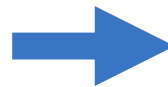
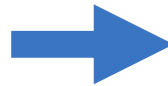
Valuation

FDO Shares are Cheap

What you get

- ▶ **Stable, secular sales growth**
- ▶ **The opportunity to invest in an existing store base at high rates of return**
- ▶ **10+ years of high return new unit growth**

- ▶ **The option that FDO closes a large productivity gap with its closest competitor, Dollar General**



What you pay

- ▶ **A modest forward multiple on consensus numbers (7.6% EBIT margin)**
 - 14.7x FY2012 EPS (August)

- ▶ **Nothing – FDO trades at nearly the same consensus forward EBIT multiple as DG (~9x), a company with similar growth prospects, excluding the productivity gap**

What Is the Productivity Gap Opportunity Worth?

If Family Dollar's square footage were as productive as Dollar General's, the company would earn ~\$6 of EPS and be worth ~\$90 per share at a 15x P/E

	Consensus		% Diff	'12 EPS
	DG	FDO		
FY 2012 Sales/sqft	\$ 210	\$ 180	17%	\$ 0.65
FY 2012 EBIT Margin	10.5%	7.6%	38%	1.46
EBIT/sqft	\$ 22.05	\$ 13.65	62%	\$ 2.36
FY 2012 EPS - Consensus				\$ 3.68
FY 2012 EPS - Pro Forma				\$ 6.03
Price at 15x EPS (Including 1.5yrs of dividends)				\$ 92
% Return				70%

What if FDO only Partly Closes the Gap?

FDO 2012 EBIT Build	% of DG Profit Gap Closed		
	0%	50%	100%
2012 Selling Sqft (mm)	51	51	51
Sales/sqft	\$ 180	\$ 195	\$ 210
EBIT Margin	7.6%	9.1%	10.5%
Pro Forma FY 2012 EBIT	\$ 692	\$ 893	\$ 1,118
Pro Forma FY 2012 EPS	\$ 3.68	\$ 4.79	\$ 6.03
2012 P/E	14.7x	11.3x	8.9x
Price @ 15x EPS	\$ 56	\$ 73	\$ 92
% Return	4%	35%	70%

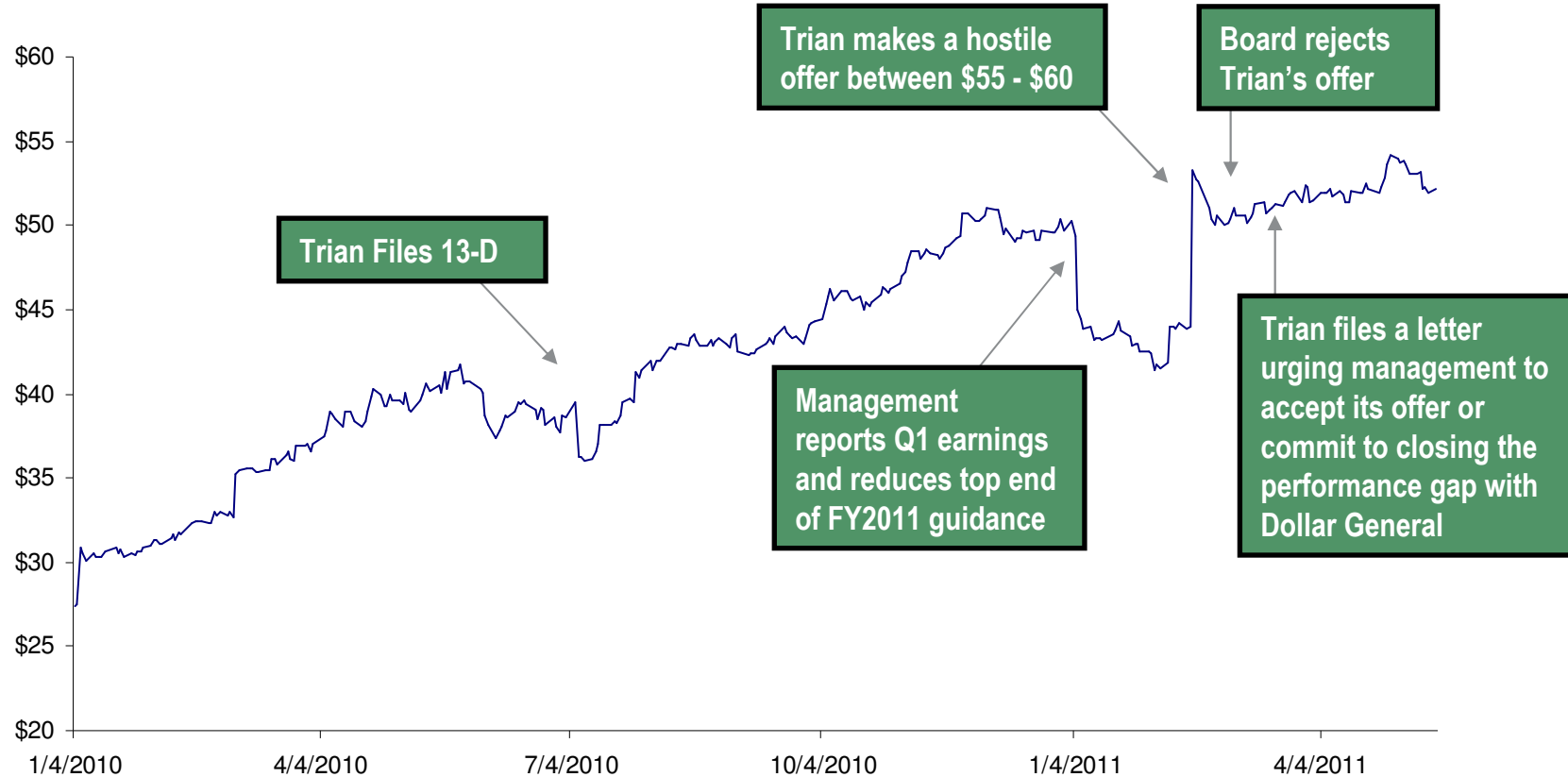
Note: Estimates for DG are FY ending Jan. 2013, and for FDO FY ending Aug. 2012
Price includes 1.5yr of dividends

Strategic Alternatives

FDO is Under Pressure to Perform

Disappointing first quarter results and the rejection of Trian's \$55 - \$60 per share offer have raised shareholder's performance expectations

Historical Stock Price



Family Dollar's Shareholder Base is Changing

Since Trian's February 15th bid, the shareholder base has changed to more opportunistic investors:

Holder Name	Shares Held	% Of Company	Change Since 12/31/10
TRIAN FUNDS	9,966	8.2%	1,130
HOWARD LEVINE (CEO)	9,691	7.9%	0
PERSHING SQUARE CAPITAL MGMT	8,369	6.9%	8,369
VANGUARD GROUP INC	6,725	5.5%	36
BANK OF AMERICA CORP	5,654	4.6%	(498)
LONE PINE CAPITAL	5,633	4.6%	900
FRANKLIN RESOURCES	5,288	4.3%	208
STATE STREET CORP	4,661	3.8%	(167)
CREDIT SUISSE AG	4,657	3.8%	489
PAULSON & CO	3,455	2.8%	3,455
BLACKROCK	3,272	2.7%	228
INTECH INVESTMENT	3,164	2.6%	824
ADAGE CAPITAL	2,448	2.0%	(970)
BANK OF NEW YORK	2,248	1.8%	528
YORK CAPITAL MANAGEMENT	1,962	1.6%	1,962
ETON PARK CAPITAL	1,782	1.5%	1,782
RENAISSANCE TECHNOLOGY	1,782	1.5%	(602)
D E SHAW & COMPANY	1,476	1.2%	(1,248)
NORTHERN TRUST	1,350	1.1%	(93)

Pershing Square purchased its position starting in February at prices between \$43 and \$54

FDO has implemented a poison pill at 9.9% that expires on March 2, 2012.

There are Multiple Ways to Achieve Full Value:

▶ Current management

- Operational Opportunity
 - Margin improvement initiatives and renovation program
- Capital Structure Opportunity
 - FDO remains under leveraged. A leveraged buy back would create meaningful value for shareholders

▶ Sale of the company

- Strategic Buyer
 - Another retailer would bring synergies to the combined company and possibly accelerate the closing of the productivity gap
- Financial Buyer
 - A private equity firm could optimize the capital structure and work with management to improve the business

How Accretive Would a Leveraged Buy Back be?

If FDO raised an incremental \$1.5bn of debt, bought back stock at \$60, and closed only half the productivity gap, the company would earn ~\$5.50 of 2012 EPS and trade in the high \$70s at a 14x P/E

Leveraged Buy Back Accretion Analysis:

Incremental Debt Raised (\$mm)	\$ 1,000	\$ 1,500	\$ 2,000
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Base EPS: Consensus

FY2012 EPS	\$ 3.91	\$ 4.04	\$ 4.19
Accretion	\$ 0.23	\$ 0.37	\$ 0.51
Value per share at 14x EPS	\$ 55	\$ 57	\$ 59

Base EPS: Pro Forma Closing 50% of Productivity Gap

FY2012 EPS	\$ 5.22	\$ 5.47	\$ 5.76
Accretion	\$ 0.42	\$ 0.68	\$ 0.96
Value per share at 14x EPS	\$ 73	\$ 77	\$ 81

Assumptions:

Incremental Debt Raised	\$ 1,000	\$ 1,500	\$ 2,000
Total Net Debt (End FY2011)	1,385	1,885	2,385
Net Debt/EBITDAR	3.8x	4.2x	4.6x
Assumed Cost of Total Debt (Gross)	5.6%	5.9%	6.1%

Trian has sourced \$5bn dollars of debt financing for their proposed deal

What Could a Strategic Buyer Pay?

A strategic buyer could justifiably pay a ~50% premium to market

	Low	Mid	High
Credit for Productivity Gap (% of total)	25%	50%	75%
\$ Value per share @15x EPS	\$ 9	\$ 18	\$ 27
Reduction in Overhead	20.0%	30.0%	40.0%
% Shared with Seller	50.0%	50.0%	50.0%
\$ Value per share @15x EPS	\$ 3	\$ 5	\$ 6
Gross Margin Expansion	0.5%	1.0%	1.5%
% Shared with Seller	50.0%	50.0%	50.0%
\$ Value per share @15x EPS	\$ 2	\$ 4	\$ 6
Total \$ Premium to Market	\$ 14	\$ 26	\$ 38
% Premium to Market	26%	48%	71%
Implied Takeout Price	\$ 68	\$ 80	\$ 92

~15% of SG&A is corporate expenses. Distribution expense is also a potential source of SG&A synergy

Possible COGS synergies include: consolidating direct sourcing operations, private label brands, and national brand buyer power

Financial Sponsor's Economics

A financial buyer could pay 40% to 55% above the current stock price and still earn a high teens to low 20s% rate of return over four years

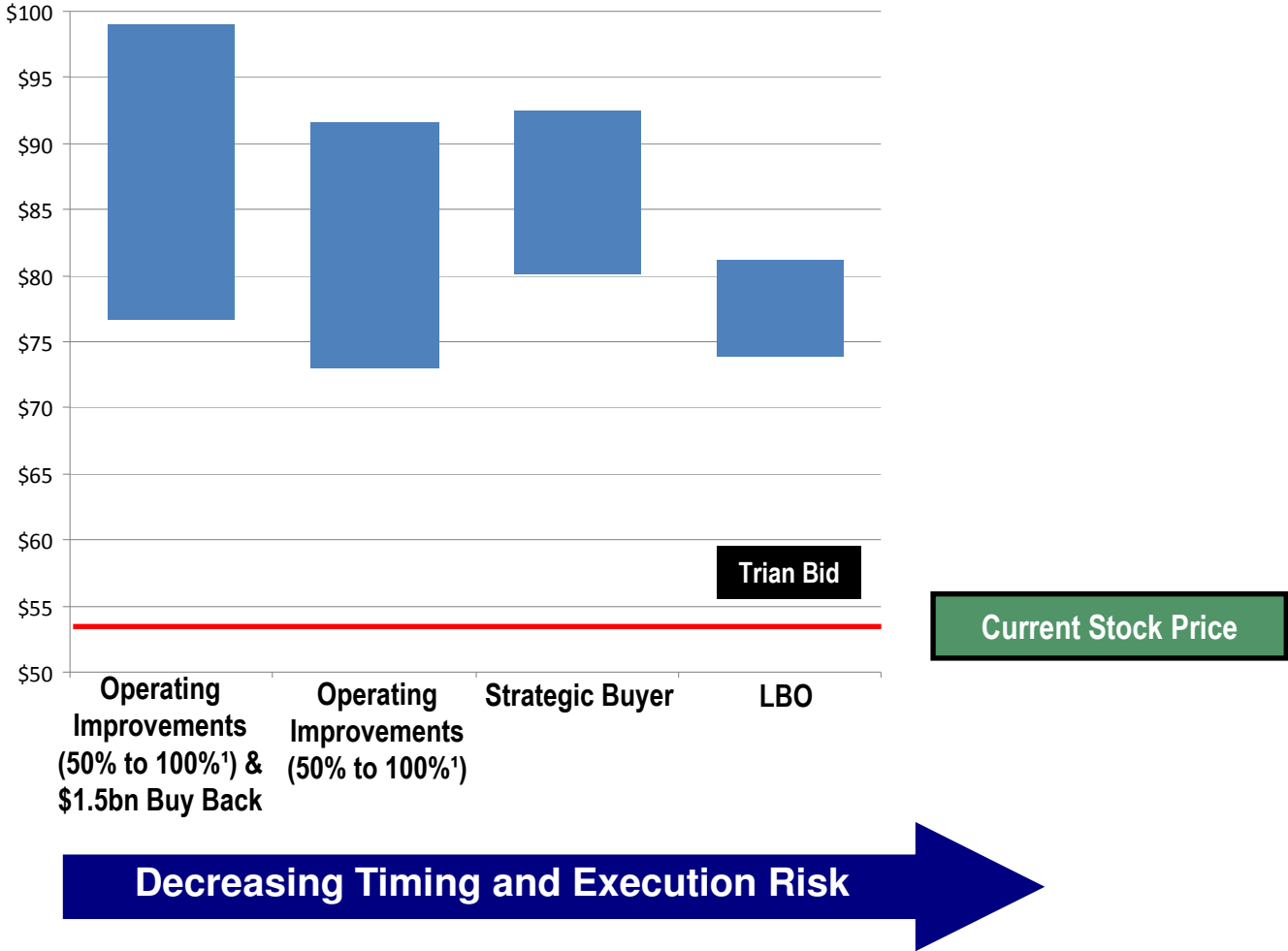
IRR Sensitivity (2015 Exit)

		Exit EBITDA Multiple (FY2016)				
		7.0x	7.5x	8.0x	8.5x	
Entry Multiple EBITDA (FY2012)	\$ 67	9.5x	24%	27%	30%	33%
	70	10.0x	21%	24%	26%	29%
	74	10.5x	17%	20%	23%	26%
	78	11.0x	15%	17%	20%	23%
	81	11.5x	12%	15%	17%	20%
	85	12.0x	10%	13%	15%	17%
	88	12.5x	8%	10%	13%	15%

Returns assume a 10% terminal EBIT margin, \$230 sales sqft in 2015, and \$5bn of leverage (7x FY2011 EBITDAR) at 7.5%

Valuation Summary

Even if we're wrong on both the value of the standalone operating opportunity and the transaction value, we believe shareholders will still make money owning FDO due to the company's attractive growth opportunities and modest forward earnings multiple



¹% of performance gap closed