FREDS INC
Form 10-Q
December 10, 2009

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

FORM 10-Q

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

For the quarterly period ended October 31, 2009.
OR

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

For the transition period from __________ to __________.

Commission file number 001-14565

FRED'S, INC.
(Exact name of registrant as specified in its charter)

TENNESSEE	62-0634010
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

4300 New Getwell Road
Memphis, Tennessee 38118
(Address of Principal Executive Offices)

(901) 365-8880
(Registrant's telephone number, including area code)

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 x No ¨.

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files). ¨ Yes ¨ No

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

Large accelerated filer ¨	Accelerated filer x

Non-accelerated filer ¨ Smaller reporting company ¨

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

The registrant had 39,669,078 shares of Class A voting, no par value common stock outstanding as of December 10, 2009.

FRED'S, INC.

INDEX

Part I – FINANCIAL INFORMATION

Item 1. Financial Statements

FRED'S, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except for number of shares)

	October 31, 2009 (unaudited)	January 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 38,555	$ 35,128
Receivables, less allowance for doubtful accounts of $701 and $885, respectively	31,723	28,857
Inventories	344,252	301,537
Other non-trade receivables	20,153	15,782
Prepaid expenses and other current assets	12,097	11,912
Total current assets	446,780	393,216
Property and equipment, at depreciated cost	139,247	138,036
Equipment under capital leases, less accumulated amortization of $4,967 and $4,928 respectively	-	39
Other noncurrent assets, net	17,652	13,484
Total assets	$ 603,679	$ 544,775
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 119,965	$ 69,955
Current portion of indebtedness	753	243
Accrued expenses and other	40,815	45,467
Deferred income taxes	14,569	13,061
Income taxes payable	-	8,941
Total current liabilities	176,102	137,667
Long-term portion of indebtedness	4,197	4,866
Deferred income taxes	1,750	1,328
Other noncurrent liabilities	18,235	13,833
Total liabilities	200,284	157,694
Commitments and Contingencies		
Shareholders' equity:		
Preferred stock, nonvoting, no par value, 10,000,000 shares authorized, none outstanding	-	-
Preferred stock, Series A junior participating nonvoting, no par value, 224,594 shares authorized, none outstanding	-	-
Common stock, Class A voting, no par value, 60,000,000 shares authorized, 40,088,028 and 39,940,148 shares issued and outstanding, respectively	138,573	136,877
Common stock, Class B nonvoting, no par value, 11,500,000 shares authorized, none outstanding	-	-
Retained earnings	263,759	249,141

Accumulated other comprehensive income		1,063		1,063
Total shareholders’ equity		403,395		387,081
Total liabilities and shareholders’ equity	$	603,679	$	544,775

See accompanying notes to condensed consolidated financial statements.

FRED'S, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(unaudited)
(in thousands, except per share amounts)

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	October 31, 2009	November 1, 2008	October 31, 2009	November 1, 2008
Net sales	$ 422,438	$ 418,036	$ 1,315,032	$ 1,329,455
Cost of goods sold	299,569	293,850	942,444	948,937
Gross profit	122,869	124,186	372,588	380,518
Depreciation and amortization	6,530	6,367	19,457	20,229
Selling, general and administrative expenses	108,678	108,416	323,633	337,202
Operating income	7,661	9,403	29,498	23,087
Interest income	(59)	(35)	(137)	(237)
Interest expense	118	94	383	546
Income before income taxes	7,602	9,344	29,252	22,778
Provision for income taxes	2,570	3,255	11,430	8,406
Net income	$ 5,032	$ 6,089	$ 17,822	$ 14,372
Net income per share				
Basic	$ 0.13	$ 0.15	$ 0.45	$ 0.36
Diluted	$ 0.13	$ 0.15	$ 0.45	$ 0.36
Weighted average shares outstanding				
Basic	39,914	39,830	39,901	39,801
Effect of dilutive stock options	68	40	88	23
Diluted	39,982	39,870	39,989	39,824
Dividends per common share	$ 0.03	$ 0.02	$ 0.08	$ 0.06
Comprehensive income:				
Net income	$ 5,032	$ 6,089	$ 17,822	$ 14,372
Other comprehensive income (expense), net of tax postretirement plan adjustment	-	(10)	-	(32)
Comprehensive income	$ 5,032	$ 6,079	$ 17,822	$ 14,340

See accompanying notes to condensed consolidated financial statements.

FRED'S, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)
(in thousands)

	For the Thirty-Nine Weeks Ended	
	October 31, 2009	November 1, 2008
Cash flows from operating activities:		
Net income	$ 17,822	$ 14,372
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	19,457	20,229
Net gain (loss) on asset disposition	156	(850)
Provision for store closures and asset impairment	-	419
Stock-based compensation	1,417	1,249
Recovery of uncollectible receivables	(184)	(143)
LIFO reserve increase	1,424	2,738
Deferred income tax expense	1,945	6,421
Income tax benefit upon exercise of stock options	23	14
Provision for post retirement medical	-	(32)
(Increase) decrease in operating assets:		
Trade receivables	(4,570)	2,451
Insurance receivables	-	834
Inventories	(44,139)	(55,563)
Other assets	(185)	(1,644)
Increase (decrease) in operating liabilities:		
Accounts payable and accrued expenses	45,359	53,967
Income taxes payable	(3,697)	-
Other noncurrent liabilities	(3,362)	1,374
Net cash provided by operating activities	31,466	45,836
Cash flows from investing activities:		
Capital expenditures	(18,368)	(14,386)
Proceeds from asset dispositions	106	2,163
Insurance recoveries for replacement assets	-	384
Asset acquisition, net (primarily intangibles)	(6,692)	(2,713)
Net cash used in investing activities	(24,954)	(14,552)
Cash flows from financing activities:		
Payments of indebtedness and capital lease obligations	(159)	(418)
Proceeds from revolving line of credit	-	215,213
Payments on revolving line of credit	-	(245,848)
Excess tax charges from stock-based compensation	(23)	(14)
Proceeds from exercise of stock options and employee stock purchase plan	301	421
Cash dividends paid	(3,204)	(2,396)
Net cash used in financing activities	(3,085)	(33,042)
Increase (decrease) in cash and cash equivalents	3,427	(1,758)
Cash and cash equivalents:		

Beginning of year		35,128		10,266
End of year	$	38,555	$	8,508
Supplemental disclosures of cash flow information:				
Interest paid	$	246	$	364
Income taxes paid	$	20,265	$	1,377
Non-cash investing and financial activities:				
Assets acquired through term loan	$	-	$	274
Common stock issued for purchase of capital assets	$	-	$	-

See accompanying notes to condensed consolidated financial statements.

FRED'S, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

NOTE 1: BASIS OF PRESENTATION

Fred's, Inc. and subsidiaries (“We”, “Our”, “Us” or “Company”) operates, as of October 31, 2009, 665 discount genera merchandise stores, including 24 franchised Fred's stores, in 15 states in the southeastern United States. 299 of the stores have full service pharmacies.

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and are presented in accordance with the requirements of Form 10-Q and therefore do not include all information and notes necessary for a fair presentation of financial position, results of operations and cash flows in conformity with GAAP. The statements do reflect all adjustments (consisting of only normal recurring accruals) which are, in the opinion of management, necessary for a fair presentation of financial position in conformity with GAAP. The statements should be read in conjunction with the Notes to the Consolidated Financial Statements for the fiscal year ended January 31, 2009 incorporated into Our Annual Report on Form 10-K.

The results of operations for the thirteen and thirty-nine week periods ended October 31, 2009 are not necessarily indicative of the results to be expected for the full fiscal year.

NOTE 2: RECENT ACCOUNTING PRONOUNCEMENTS

In June 2009, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 168, “The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles – a replacement of SFAS No. 162” (“FASB ASC 105”). FASB ASC 105 modifies the GAAP hierarchy by establishing only two levels of GAAP, authoritative and nonauthoritative accounting literature. Effective July 2009, the FASB Accounting Standards Codification (“ASC”), also known collectively as the “Codification”, is considered the single source of authoritative U.S. accounting and reporting standards, except for additional authoritative rules and interpretive releases issued by the SEC. The Codification was developed to organize GAAP pronouncements by topic so that users can more easily access authoritative accounting guidance. FASB ASC 105 became effective for the third quarter of fiscal year 2009. All other accounting standards references have been updated in this report with ASC references.

In May 2009, the FASB issued FASB ASC 855, “Subsequent Events”, which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. FASB ASC 855 requires issuers to reflect in their financial statements and disclosures the effects of subsequent events that provide additional evidence about conditions at the balance sheet date. Disclosures should include the nature of the event and either an estimate of its financial effect or a statement that an estimate cannot be made. This standard also requires issuers to disclose the date through which they have evaluated subsequent events and whether the date corresponds with the release of their financial statements. The Company adopted FASB ASC 855 as of the interim period ended August 1, 2009. The Company has evaluated subsequent events through December 10, 2009, the date it filed this quarterly report on Form 10-Q. As the requirements under FASB ASC 855 are consistent with its current practice, the implementation of this standard did not have an impact on the Company’s consolidated financial statements.

In June 2008, the FASB issued FASB ASC 260, which addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and therefore need to be included in the earnings allocation in computing earnings per share (EPS) under the two-class method described in FASB ASC 260, “Earnings Per Share”. This FASB ASC is effective for fiscal periods beginning after December 15, 2008. The Company adopted FASB ASC 260 in the quarter ended May 2, 2009 and determined that it had no significant impact on its results of operations or financial position.

In September 2006, the FASB issued FASB ASC 820, "Fair Value Measurements and Disclosures". FASB ASC 820 provides a single definition of fair value, together with a framework for measuring it, and requires additional disclosure about the use of fair value to measure assets and liabilities. FASB ASC 820 also emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. Under FASB ASC 820, fair value measurements are required to be disclosed by level within that hierarchy. FASB ASC 820 is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. However, FASB ASC 820-10-65-1, issued in February 2008, delays the effective date of FASB ASC 820 for all nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis, to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The Company adopted FASB ASC 820 effective February 3, 2008, and its adoption did not have a material effect on its results of operations or financial position. The Company has also evaluated FASB ASC 820-10-65-1 and determined that it will have no impact on its results of operations or financial position. In October 2008, the FASB issued ASC 820-10-65-2, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active". FASB ASC 820-10-65-2 clarifies the application of FASB ASC 820 when the market for a financial asset is inactive. The guidance in FASB ASC 820-10-65-2 is effective immediately and has no effect on our financial statements. In April 2009, the FASB issued ASC 820-10-65-4, "Determining Fair Value When the Level and Volume of Activity for the Asset or Liability have Significantly Decreased and Identifying Transactions That Are Not Orderly" which further clarifies the principles established by FASB ASC 820. The guidance is effective for the periods ending after June 15, 2009 with early adoption permitted for the periods ending after March 15, 2009. The Company has evaluated FASB ASC 820-10-65-4 and determined that it will have no impact on its results of operations or financial position.

NOTE 3: INVENTORIES

Merchandise inventories are valued at the lower of cost or market using the retail first-in, first-out ("FIFO") method for goods in our stores and the cost FIFO method for goods in our distribution centers. The retail inventory method is a reverse mark-up, averaging method which has been widely used in the retail industry for many years. This method calculates a cost-to-retail ratio that is applied to the retail value of inventory to determine the cost value of inventory and the resulting cost of goods sold and gross margin. The assumption that the retail inventory method provides for valuation at lower of cost or market and the inherent uncertainties therein are discussed in the following paragraphs.

In order to assure valuation at the lower of cost or market, the retail value of our inventory is adjusted on a consistent basis to reflect current market conditions. These adjustments include increases to the retail value of inventory for initial markups to set the selling price of goods or additional markups to adjust pricing for inflation and decreases to the retail value of inventory for markdowns associated with promotional, seasonal or other declines in the market value. Because these adjustments are made on a consistent basis and are based on current prevailing market conditions, they approximate the carrying value of the inventory at net realizable value ("market value"). Therefore, after applying the cost to retail ratio, the cost value of our inventory is stated at the lower of cost or market as is prescribed by GAAP.

Because the approximation of market value under the retail inventory method is based on estimates such as markups, markdowns and inventory losses ("shrink"), there exists an inherent uncertainty in the final determination of inventory cost and gross margin. In order to mitigate that uncertainty, the Company has a formal review by product class which considers such variables as current market trends, seasonality, weather patterns and age of merchandise to ensure that markdowns are taken currently, or a markdown reserve is established to cover future anticipated markdowns. This review also considers current pricing trends and inflation to ensure that markups are taken if necessary. The estimation of shrink is a significant element in approximating the carrying value of inventory at net realizable value, and as such the following paragraph describes our estimation method as well as the steps we take to mitigate the risk of this estimate in the determination of the cost value of inventory.

The Company calculates shrink based on actual inventory losses occurring as a result of physical inventory counts during each fiscal period and estimated inventory losses occurring between yearly physical inventory counts. The estimate for shrink occurring in the interim period between physical counts is calculated on a store-specific basis and is based on history, as well as performance on the most recent physical count. It is calculated by multiplying each store's shrink rate, which is based on the previously mentioned factors, by the interim period's sales for each store. Additionally, the overall estimate for shrink is adjusted at the corporate level to a three-year historical average to ensure that the overall shrink estimate is the most accurate approximation of shrink based on the Company's overall history of shrink. The three-year historical estimate is calculated by dividing the "book to physical" inventory adjustments for the trailing 36 months by the related sales for the same period. In order to reduce the uncertainty inherent in the shrink calculation, the Company first performs the calculation at the lowest practical level (by store) using the most current performance indicators. This ensures a more reliable number, as opposed to using a higher level aggregation or percentage method. The second portion of the calculation ensures that the extreme negative or positive performance of any particular store or group of stores does not skew the overall estimation of shrink. This portion of the calculation removes additional uncertainty by eliminating short-term peaks and valleys that could otherwise cause the underlying carrying cost of inventory to fluctuate unnecessarily. The Company has not experienced any significant change in shrink as a percentage of sales from year to year during the subject reporting periods.

Management believes that the Company's Retail Inventory Method provides an inventory valuation which reasonably approximates cost and results in carrying inventory at the lower of cost or market. For pharmacy inventories, which were approximately $29.1 million, and $30.8 million at October 31, 2009 and January 31, 2009 respectively, cost was determined using the retail last-in, first-out ("LIFO") method in which inventory cost is maintained using the Retail Inventory Method, then adjusted by application of the Producer Price Index published by the U.S. Department of Labor for the cumulative annual periods. The current cost of inventories exceeded the LIFO cost by approximately $20.6 million at October 31, 2009 and $19.1 million at January 31, 2009.

The Company has historically included an estimate of inbound freight and certain general and administrative costs in merchandise inventory as prescribed by GAAP. These costs include activities surrounding the procurement and storage of merchandise inventory such as merchandise planning and buying, warehousing, and various administrative functions related to those activities such as accounting, information technology and human resources. The total amount of procurement and storage costs and inbound freight included in merchandise inventory at October 31, 2009 is $20.4 million, with the corresponding amount of $19.0 million at January 31, 2009.

NOTE 4: STOCK-BASED COMPENSATION

The Company accounts for its stock-based compensation plans in accordance with FASB ASC 718 "Compensation – Stock Compensation". Under FASB ASC 718, stock-based compensation expense is based on awards ultimately expected to vest, and therefore has been reduced for estimated forfeitures. Forfeitures are estimated at the time of grant based on the Company's historical forfeiture experience and will be revised in subsequent periods if actual forfeitures differ from those estimates.

FASB ASC 718 also requires the benefits of income tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required prior to FASB ASC 718.

A summary of the Company's stock-based compensation (a component of selling and general and administrative expenses) and related income tax benefit is as follows (in thousands):

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	October 31, 2009	November 1, 2008	October 31, 2009	November 1, 2008
Stock option expense	$ 235	$ (85)	$ 775	$ 564
Restricted stock expense	133	197	482	552
ESPP expense	53	44	160	133
Total stock-based compensation	$ 421	$ 156	$ 1,417	$ 1,249
Income tax benefit on stock-based compensation	$ 83	$ 79	$ 298	$ 305

The fair value of each option granted during the thirteen and thrirty-nine week periods ended October 31, 2009 and November 1, 2008, respectively, are estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	October 31, 2009	November 1, 2008	October 31, 2009	November 1, 2008
Stock Options				
Expected volatility	41.8%	39.0%	42.6%	40.2%
Risk-free interest rate	2.7%	3.4%	2.6%	3.4%
Expected option life (in years)	5.84	5.84	5.84	5.84
Expected dividend yield	0.55%	0.50%	0.55%	0.45%
Weighted average fair value at grant date	$ 5.11	$ 5.87	$ 4.63	$ 4.66
Employee Stock Purchase Plan				
Expected volatility	64.9% 1	33.5%	77.6% 1	37.4%
Risk-free interest rate	0.1%	3.1%	0.1%	3.1%
Expected option life (in years)	0.75	0.75	0.5	0.5
Expected dividend yield	0.51%	0.51%	0.34%	0.34%
Weighted average fair value at grant date	$ 3.94	$ 2.54	$ 3.77	$ 2.39

1. The increase in expected volatility is due to the fluctuation of the stock price in first three quarters of 2009 as compared to the same periods last year.

The following is a summary of the methodology applied to develop each assumption:

Expected Volatility - This is a measure of the amount by which a price has fluctuated or is expected to fluctuate. The Company uses actual historical changes in the market value of our stock to calculate expected price volatility because management believes that this is the best indicator of future volatility. The Company calculates weekly market value changes from the date of grant over a past period representative of the expected life of the options to determine volatility. An increase in the expected volatility will increase compensation expense.

Risk-free Interest Rate - This is the yield of a U.S. Treasury zero-coupon bond issue effective at the grant date with a remaining term equal to the expected life of the option. An increase in the risk-free interest rate will increase compensation expense.

Expected Lives - This is the period of time over which the options granted are expected to remain outstanding and is based on historical experience. Options granted have a maximum term of seven and one-half years. An increase in the expected life will increase compensation expense.

Dividend Yield – This is based on the historical yield for a period equivalent to the expected life of the option. An increase in the dividend yield will decrease compensation expense.

Forfeiture Rate - This is the estimated percentage of options granted that are expected to be forfeited or cancelled before becoming fully vested. This estimate is based on historical experience. An increase in the forfeiture rate will decrease compensation expense.

Employee Stock Purchase Plan

The 2004 Employee Stock Purchase Plan (the “2004 Plan”), which was approved by Fred’s stockholders, permits eligible employees to purchase shares of our common stock through payroll deductions at the lower of 85% of the fair market value of the stock at the time of grant or 85% of the fair market value at the time of exercise. There were 43,576 shares issued during the thirty-nine weeks ended October 31, 2009. There are 1,410,928 shares approved to be issued under the 2004 Plan and as of October 31, 2009, there were 1,107,287 shares available.

Stock Options

The following table summarizes stock option activity during the thirty-nine weeks ended October 31, 2009:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value (Thousands)
Outstanding at January 31, 2009	1,138,111	$ 15.13	3.9	$ 11
Granted	361,891	$ 11.20		
Forfeited / Cancelled	(102,853)	$ 18.90		
Exercised	(600)	$ 13.25		
Outstanding at October 31, 2009	1,396,549	$ 13.84	3.6	$ 699
Exercisable at October 31, 2009	784,442	$ 15.60	2.1	$ 163

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between Fred’s closing stock price of $11.84 on the last trading day of the period ended October 31, 2009 and the exercise price of the option multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on that date. As of October 31, 2009, total unrecognized stock-based compensation expense net of estimated forfeitures related to non-vested stock options was approximately $1.4 million, which is expected to be recognized over a weighted average period of approximately 4.0 years. The total fair value of options vested during the thirty-nine weeks ended October 31, 2009 was $1.1 million.

Restricted Stock

The following table summarizes restricted stock activity during the thirty-nine weeks ended October 31, 2009:

	Number of Shares	Weighted Average Grant Date Fair Value
Non-vested Restricted Stock at January 31, 2009	352,784	$ 12.39
Granted	52,843	$ 12.62
Forfeited / Cancelled	(29,071)	$ 13.99
Vested	(23,530)	$ 15.11
Non-vested Restricted Stock at October 31, 2009	353,026	$ 12.12

The aggregate pre-tax intrinsic value of restricted stock outstanding as of October 31, 2009 is $4.2 million with a weighted average remaining contractual life of 5.7 years. The unrecognized compensation expense net of estimated forfeitures, related to the outstanding stock is approximately $2.5 million, which is expected to be recognized over a weighted average period of approximately 5.3 years. The total fair value of restricted stock awards that vested during the thirty-nine weeks ended October 31, 2009 was $355.8 thousand.

NOTE 5: PROPERTY AND EQUIPMENT

Property and Equipment are carried at cost. Depreciation is recorded using the straight-line method over the estimated useful lives of the assets. Improvements to leased premises are amortized using the straight-line method over the shorter of the initial term of the lease or the useful life of the improvement. Leasehold improvements added late in the lease term are amortized over the shorter of the remaining term of the lease (including the upcoming renewal option, if the renewal is reasonably assured) or the useful life of the improvement. Assets under capital leases are amortized in accordance with the Company's normal depreciation policy for owned assets or over the lease term (regardless of renewal options), if shorter, and the charge to earnings is included in depreciation expense in the consolidated financial statements. Gains or losses on the sale of assets are recorded as a component of operating income.

The following illustrates the breakdown of the major categories within Property and Equipment:

	October 31, 2009 (unaudited)	January 31, 2009
Property and equipment, at cost:		
Buildings and building improvements	$ 94,752	$ 91,826
Leasehold improvements	54,204	49,775
Automobiles and vehicles	5,543	5,223
Airplane	4,697	4,697
Furniture, fixtures and equipment	238,942	230,272
	398,138	381,793
Less: Accumulated depreciation and amortization	(265,719)	(251,002)
	132,419	130,791
Construction in progress	295	912
Land	6,533	6,333
Total Property and equipment, at depreciated cost	$ 139,247	$ 138,036

NOTE 6: EXIT AND DISPOSAL ACTIVITIES

Store closures that are deemed exit and disposal related, will be accounted for in accordance with FASB ASC 420, "Exit or Disposal Cost Obligations" as follows. None of the 9 store closures in 2009 were exit and disposal related.

Inventory Impairment

The Company will record a below-cost inventory adjustment to reduce the value of inventory to the lower of cost or market in stores that are planned for closure. The adjustment would be recorded in cost of goods sold in the Condensed Consolidated Statement of Income. There is no outstanding inventory impairment for exit and disposal related activity.

Fixed Asset Impairment

For planned store closures, the Company will record a fixed asset impairment charge for assets identified for disposal. There is no outstanding fixed asset impairment for exit and disposal related activity.

Lease Termination

For store closures where a lease obligation still exists, we record the estimated future liability associated with the rental obligation on the cease use date (when the store is closed). Liabilities are established at the cease use date for the present value of any remaining operating lease obligations, net of estimated sublease income, and at the communication date for severance and other exit costs, as prescribed by FASB ASC 420. Key assumptions in calculating the liability include the timeframe expected to terminate lease agreements, estimates related to the sublease potential of closed locations, and estimation of other related exit costs. If actual timing and potential termination costs or realization of sublease income differ from our estimates, the resulting liabilities could vary from recorded amounts. These liabilities are reviewed periodically and adjusted when necessary.

During the first three quarters of fiscal 2009, we incurred an additional $0.1 million in rent expense related to the revision in the estimate of buyout amounts and the extension of the timeframe expected to terminate the remaining lease agreements of the fiscal 2008 store closures. We also utilized $2.1 million, leaving $1.5 million in the reserve at October 31, 2009.

The following table illustrates the exit and disposal activity related to the store closures discussed in the previous paragraphs (in millions):

	Balance at January 31, 2009	Additions FY09	Utilized FY09	Balance at October 31, 2009
Lease contract termination liability	3.5	0.1	2.1	1.5
	$ 3.5	$ 0.1	$ 2.1	$ 1.5

NOTE 7: ACCUMULATED OTHER COMPREHENSIVE INCOME

Comprehensive income consists of two components, net income and other comprehensive income (loss). Other comprehensive income (loss) refers to gains and losses that under GAAP are recorded as an element of shareholders' equity but are excluded from net income. The Company's accumulated other comprehensive income includes the unrecognized prior service costs, transition obligations and actuarial gains/losses associated with our postretirement benefit plan.

The following table illustrates the activity in accumulated other comprehensive income:

(in thousands)	Thirty-nine Weeks Ended October 31, 2009	Thirty-nine Weeks Ended November 1, 2008	Year Ended January 31, 2009
Accumulated other comprehensive income	$ 1,063	$ 1,040	$ 1,040
Amortization of postretirement benefit	-	(32)	23
Ending balance	$ 1,063	$ 1,008	$ 1,063

NOTE 8: RELATED PARTY TRANSACTIONS

Atlantic Retail Investors, LLC, which is partially owned by Michael J. Hayes, a director of the Company, owns the land and buildings occupied by twelve FRED'S stores. The terms and conditions regarding the leases on these locations are consistent in all material respects with other stores leases of the Company. The total rental payments related to these leases were $299.4 thousand and $974.4 thousand for the thirteen and thirty-nine week periods ended October 31, 2009.

Item 2:

Management's Discussion and Analysis of Financial Condition and Results of Operations

GENERAL

Executive Overview

Recognizing our pharmacy department as a key differentiating factor to other small-box discount retailers, we have accelerated our growth strategy in this area and are aggressively pursuing opportunities to acquire independent pharmacies within our targeted markets. Our emphasis will continue to be on acquisitions and prescription file buys, but cold starts will be employed where it makes sense to do so. As we mentioned previously, we began offering our Prescription Plus $4 generic program to all pharmacies in the chain. We piloted this program on a limited basis last year and found it to be a traffic driver, and thus rolled it out to all pharmacies in the first quarter. We are pleased with this deployment and its effect on our prescription count.

Our Own Brand initiative continues to be a key strategy for the Company in terms of building customer loyalty and increasing gross margin. We have reached an Own Brand penetration rate of approximately 16% of total consumable sales, and that number will continue to grow throughout the remainder of the year as new Own Brand products are introduced. Our commitment to quality in our Own Brand products is resonating with our customers and they continue to make the switch to our “Fred’s Brand”. We are continuing to add new products to our Own Brand line on an ongoing basis, with new items in chemicals and food introduced in the second quarter of 2009.

Expense reduction and containment continues to be a key focus of the Company, especially in light of current economic conditions. We are aggressively pursuing cost reductions in all functional areas and are also continuously reviewing internal processes to find efficiencies and/or redundancies and drive unnecessary costs and expenses out of the business. These efforts are being coordinated at the Executive Level and close attention is being paid not to sacrifice service to our customers. These efforts resulted in a 80 basis point reduction in expenses as a percentage of sales on a year to date basis in 2009 compared to the same period last year.

Improving inventory productivity has been a key focus throughout FY 2009. Initiatives set in motion in FY 2008, such as reducing the store fixture profile to remove inventory displayed above eye level, improvement in seasonal buying to reduce pack away inventory and continuous improvement in the line review process, have resulted in a 7.7% reduction in total company inventory from the same period last year. This reduction in inventory was accomplished without jeopardizing our in-stock positions or the merchandise selection available to our customers.

Also in the third quarter, we continued refining our real estate site selection and store layout programs. We continue to improve the interior layout of our stores so that our customers experience more open customer spaces, more logical product flow and a more consistent and meaningful price message, all of which are intended to provide a more pleasurable shopping trip. We also continue to hone our real estate strategy so that the proper site is selected to support our targeted demographics, thus driving traffic and sales. Many of these efforts culminated in the third quarter with the grand opening of our “Pilot Store of the Future”.

Throughout 2009, we have continued with capital improvements in infrastructure, including new stores as well as existing store expansion and remodels, distribution center upgrades and further development of our information technology capabilities. Technology upgrades have been made in the areas of direct store delivery systems, in-store systems, and pharmacy systems.

As previously reported, the Company expects total earnings per diluted share for 2009 to be in the range of $0.62 to $0.69. These earnings projections include the following significant events affecting the balance of the year:

- The third year incremental raising of the federal minimum wage which will negatively impact our labor expense by approximately $2.3 million, effective July 24, 2009.
- The continued product mix shift to basic and consumable items, coupled with intense pharmacy competition, will continue to negatively affect gross margin.
- The positive margin impact of our Own Brand initiatives as mentioned in previous paragraphs.

Key factors that will be critical to the Company's future success include managing the strategy for opening new stores and pharmacies, including the ability to open and operate efficiently, maintaining high standards of customer service, maximizing efficiencies in the supply chain, controlling working capital needs through improved inventory turnover, managing the effects of inflation or deflation, controlling product mix, increasing operating margin through improved gross margin and leveraging operating costs, and generating adequate cash flow to fund the Company's future needs.

Other factors that will affect Company performance in 2009 include the continuing management of the impacts of the changing regulatory environment in which our pharmacy department operates. Additionally, we believe that the prolonged recession and elevated unemployment rate continue to place tremendous economic pressure on the consumer. However, we also continue to believe that our affordable pricing and value proposition make us an attractive destination to wary consumers.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Company's discussion and analysis of its financial condition and results of operations are based upon the Company's condensed financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The critical accounting matters that are particularly important to the portrayal of the Company's financial condition and results of operations and require some of management's most difficult, subjective and complex judgments are described in detail in the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2009. The preparation of condensed financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, the Company evaluates its estimates, including those related to inventories, income taxes, insurance reserves, contingencies and litigation. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

RESULTS OF OPERATIONS

THIRTEEN WEEKS ENDED OCTOBER 31, 2009 AND NOVEMBER 1, 2008

Sales
Net sales for the third quarter of 2009 increased to $422.4 million from $418.0 million in 2008, a quarter-over-quarter increase of $4.4 million or 1.1%. Sales in the quarter were adversely affected by layaway sales of $3.6 million, a significant increase over the $.6 million of layaway sales in the third quarter of 2008, which were deferred until the merchandise is picked up in the fourth quarter. Excluding sales from stores closed in 2008 ($2.7 million), total sales were up $7.1 million or 1.7% over the third quarter last year. On a comparable store basis, sales in the third quarter increased 1.0% ($3.9 million) compared with a 1.4% ($3.2 million) increase in the same period last year.

The Company's 2009 front store (non-pharmacy) sales decreased 1.7% over 2008 front store sales. Excluding the front store sales from stores closed in 2008 ($2.7 million), sales decreased .7% over the third quarter last year. Although front store sales growth declined in the quarter in categories such as candy, prepaid products, hardware and health and beauty aids, we did experience sales increases in the more discretionary categories such as tobacco, greeting cards and electronics.

The Company's pharmacy sales were 35.6% of total sales in the third quarter of 2009 compared to 33.7% of total sales in the same quarter last year and continue to rank as the largest sales category within the Company. The total sales in this department, including the Company's mail order operation which we closed during the first quarter of 2009, increased 6.6% over 2008, with third party prescription sales representing approximately 93% of total pharmacy sales, the same as in the prior year. The Company's pharmacy department continues to benefit from an ongoing program of purchasing prescription files from independent pharmacies as well as the addition of pharmacy departments in existing store locations.

Sales to FRED'S 24 franchised locations during the third quarter of 2009 decreased to $9.9 million (2.5% of sales) from $10.2 million (2.4% of sales) in 2008. The decrease in quarter over quarter franchise sales resulted from the ongoing economic challenges impacting our customers' disposable income. The Company does not intend to expand its franchise network in the future.

The sales mix for the period, unadjusted for deferred layaway sales, was 35.1% Pharmaceuticals, 20.8% Household Goods, 16.5% Food and Tobacco, 9.8% Paper and Cleaning Supplies, 7.4% Apparel and Linens, 7.9% Health and Beauty Aids, and 2.5% Franchise. The sales mix for the same period last year was 33.7% Pharmaceuticals, 21.7% Household Goods, 16.4% Food and Tobacco, 9.9% Paper and Cleaning Supplies, 7.7% Apparel and Linens, 8.2% Health and Beauty Aids, and 2.4% Franchise.

For the quarter, comparable store customer traffic decreased 1.4% over the same quarter last year while the average customer ticket increased 2.4% to $18.95.

Gross Profit

Gross profit for the third quarter of 2009 decreased to $122.9 million from $124.2 million in 2008, a quarter-over-quarter decline of $1.3 million or 1.1%. Gross margin, measured as a percentage of sales, declined to 29.1% from 29.7% in the same quarter last year. Gross margin was unfavorably impacted by continued competitive pressures, higher promotional markdowns, an unfavorable shift in the product mix toward lower margin basic and consumable products while being favorably impacted by an increase in vendor dollar consideration. Also, the markdowns recognized in the closing of 9 underperforming stores in the quarter had an unfavorable impact on gross margin. This impact was partially offset by higher general merchandise department markup and improved shrink experience.

Selling, General and Administrative Expenses

Selling, general and administrative expenses, including depreciation and amortization, increased to $115.2 million in 2009 (27.3% of sales) from $114.8 million in 2008 (27.5% of sales).

Operating Income

Operating income decreased to $7.7 million in the third quarter of 2009 (1.8% of sales) from $9.4 million in 2008 (2.2% of sales) due primarily to a decrease in gross profit of $1.3 million (1.1% of sales), as described in the Gross Profit section above, as well as the increase in selling, general and administrative expenses of $.4 million.

Interest Expense

The Company incurred net interest expense of $0.1 million in the third quarter of 2009 and 2008.

Income Taxes

For the third quarter of 2009, the effective income tax rate was 33.8%, as compared to 34.8% in the third quarter of 2008. The decrease in the effective tax rate was primarily due to increased benefits from employment related federal tax credits.

Net Income

As a result of the fluctuations described in the preceding sections, net income decreased 17.4% to $5.0 million (or $.13 per diluted share) in the third quarter of 2009 from $6.1 million (or $.15 per diluted share) during the same period last year. While net sales increased by $4.4 million, the reduction in gross margin of $1.3 million and the increase in selling, general and administrative expenses of $.4 million over the same period last year, more than offset this favorability.

THIRTY-NINE WEEKS ENDED OCTOBER 31, 2009 AND NOVEMBER 1, 2008

Sales

Net sales decreased to $1,315.0 million in 2009 from $1,329.5 million in 2008, a year-over-year decline of $14.4 million or 1.1%, reflecting the Company's store closing program coupled with the ongoing economic challenges impacting our customers' disposable income. Excluding sales from stores closed in 2008 ($40.3 million), total sales increased 2.0% ($25.9 million) over last year. This increase was attributable to an increase in comparable store sales of .8% ($10.4 million) and increase in non-comparable store sales of 1.2% ($15.5 million).

The Company's 2009 front store (non-pharmacy) sales decreased 3.8% over 2008 front store sales. Excluding the front store sales from stores closed in 2008 ($40.3 million), sales increased .9% over last year. Although front store sales growth declined in the first three quarters in the more discretionary categories such as home furnishings, health and beauty aids, housewares and footwear, we did experience sales increases in consumable categories such as tobacco, food and pets as well as in greeting cards.

The Company's pharmacy sales were 33.8% of total sales in the first three quarters of 2009 compared to 32.0% of total sales in the same period last year and continue to rank as the largest sales category within the Company. The total sales in this department, including the Company's mail order operation, which we closed during the first quarter of 2009, increased 4.6% over 2008, with third party prescription sales representing approximately 93% of total pharmacy sales, the same as in the prior year. The Company's pharmacy department continues to benefit from an ongoing program of purchasing prescription files from independent pharmacies as well as the addition of pharmacy departments in existing store locations.

Sales to FRED'S 24 franchised locations during the first three quarters of 2009 decreased to $29.4 million (2.3% of sales) from $30.2 million (2.3% of sales) in 2008. The decrease in year-over-year franchise sales were a result of the ongoing economic challenges impacting our customers' disposable income.

The sales mix for the period, unadjusted for deferred layaway sales, was 33.7% Pharmaceuticals, 22.7% Household Goods, 16.4% Food and Tobacco, 9.5% Paper and Cleaning Supplies, 7.7% Apparel and Linens, 7.7% Health and Beauty Aids, and 2.3% Franchise. The sales mix for the same period last year was 32.0% Pharmaceuticals, 23.9% Household Goods, 15.7% Food and Tobacco, 8.6% Apparel and Linens, 9.4% Paper and Cleaning Supplies, 8.1% Health and Beauty Aids, and 2.3% Franchise.

For the year, comparable store customer traffic was flat over the same period last year while the average customer ticket increased 0.8% to $19.02.

Gross Profit
Gross profit for the first three quarters of 2009 decreased to $372.6 million from $380.5 million in 2008, a year-over-year decline of $7.9 million or 2.1%. Gross margin, measured as a percentage of sales, declined to 28.3% from 28.6% last year. Gross margin was unfavorably impacted by continued competitive pressures, higher promotional markdowns, an unfavorable shift in the product mix toward lower margin basic and consumable products while being favorably impacted by an increase in vendor dollar consideration.

Selling, General and Administrative Expenses
Selling, general and administrative expenses, including depreciation and amortization, decreased to $343.1 million in 2009 (26.1% of sales) from $357.4 million in 2008 (26.9% of sales). This 80 basis point expense leverage resulted primarily from the effect of our store closures in fiscal 2008 ($8.9 million), lowering distribution costs ($3.6 million) and managing costs in our stores by reducing utility expense ($2.0 million) with the installation of Energy Management Systems.

Operating Income
Operating income increased 27.8% to $29.5 million in the first three quarters of 2009 (2.2% of sales) from $23.1 million in 2008 (1.7% of sales) due primarily to a reduction in selling, general and administrative expenses as the Company did not incur expenses related to store closures in the first three quarters of this year as well as continued focus on managing costs in our stores and distribution centers, as described in the Selling, General and Administrative Expenses section above. This favorability in expenses was partially offset by a decrease in gross profit of $7.9 million, a year-over-year decline of 2.1%, as described in the Gross Profit section above.

Interest Expense
The Company incurred net interest expense of $0.2 million and $0.3 million in the first three quarters of 2009 and 2008, respectively.

Income Taxes
For the first three quarters of 2009, the effective income tax rate was 39.1%, as compared to 36.9% for the same period last year. The increase in the effective tax rate was primarily due to the final assessment and settlement in the second quarter of the Internal Revenue Service exam for tax years 2004 – 2007. We anticipate the tax rate for the last quarter of the year to be in the range of 35% to 37%.

Net Income
As a result of the fluctuations described in the preceding sections, net income increased 24.0% to $17.9 million (or $.45 per diluted share) in the first three quarters of 2009 from $14.4 million (or $.36 per diluted share) during the same period last year. While net sales decreased by $14.4 million and gross profit decreased $7.9 million over the

same period last year, the improvement in selling, general and administrative expenses as a percent of sales $14.3 million more than offset this unfavorability.

LIQUIDITY AND CAPITAL RESOURCES

Due to the seasonality of our business and the continued increase in the number of stores and pharmacies, inventories are generally lower at year-end than at each quarter-end of the following year.

Cash provided by operating activities totaled $31.5 million during the thirty-nine week period ended October 31, 2009 compared to $45.9 million in the same period of the prior year. While cash was used for the purchase of inventories, we generated operating cash flow through quarterly income and from our ongoing initiative to better manage our Accounts Payable processes.

Cash used in investing activities totaled $25.0 million, and consisted primarily of expenditures related to existing stores ($12.6 million), pharmacy acquisitions ($6.7 million), capital expenditures associated with the store and pharmacy expansion program ($2.2 million) and technology and other corporate expenditures ($3.6 million). During the first nine months of 2009, we opened 11 stores and 18 pharmacies and closed 9 stores and 3 pharmacies. In 2009, the Company is planning capital expenditures totaling approximately $21.4 million. Expenditures are planned totaling approximately $13.5 million for upgrades, remodels, or new stores and pharmacies; $3.9 million for technology upgrades $2.4 million for distribution center equipment and capital replacements and $1.6 million for other corporate expenditures. In addition, the Company also plans expenditures of $5.0 million for the acquisition of customer lists and other pharmacy related items. Depreciation expense for 2009 will be approximately $26.0 million.

Cash used by financing activities totaled $3.1 million and included $3.2 million for the payment of cash dividends and was offset by $0.3 million in proceeds from the exercise of stock options and employee stock purchase plan. There were $5.0 million in borrowings outstanding at October 31, 2009 related to real estate mortgages compared to $5.1 million at January 31, 2009.

We believe that sufficient capital resources are available in both the short-term and long-term through currently available cash and cash generated from future operations and, if necessary, the ability to obtain additional financing.

FORWARD-LOOKING STATEMENTS

Other than statements based on historical facts, many of the matters discussed in this Form 10-Q relate to events which we expect or anticipate may occur in the future. Such statements are defined as “forward-looking statements” under the Private Securities Litigation Reform Act of 1995 (the “Reform Act”), 15 U.S.C. Sections 77z-2 and 78u-5. The Reform Act created a safe harbor to protect companies from securities law liability in connection with forward-looking statements. We intend to qualify both our written and oral forward-looking statements for protection under the Reform Act and any other similar safe harbor provisions.

The words “believe”, “anticipate”, “project”, “plan”, “expect”, “estimate”, “objective”, “forecast”, “goal”, “intend”, “will likel continue” and similar expressions generally identify forward-looking statements. All forward-looking statements are inherently uncertain, and concern matters that involve risks and other factors that may cause the actual performance of the Company to differ materially from the performance expressed or implied by these statements. Therefore, forward-looking statements should be evaluated in the context of these uncertainties and risks, including but not limited to:

- Economic and weather conditions which affect buying patterns of our customers and supply chain efficiency.
- Changes in consumer spending and our ability to anticipate buying patterns and implement appropriate inventory strategies.
- Continued availability of capital and financing.
- Competitive factors.

- Changes in reimbursement practices for pharmaceuticals.
- Governmental regulation.
- Increases in fuel and utility rates.
- Potential adverse results in the Fair Labor Standards Act (“FSLA”) litigation described under Legal Proceedings on page 20.
- Other factors affecting business beyond our control, including (but not limited to) those discussed under Part 1, ITEM 1A “Risk Factors” of the Company’s Annual Report on Form 10-K for the fiscal year ended January 31, 2009.

Consequently, all forward-looking statements are qualified by this cautionary statement. Readers should not place undue reliance on any forward-looking statements. We undertake no obligation to update any forward-looking statement to reflect events or circumstances arising after the date on which it was made.

Item 3.

QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

We have no holdings of derivative financial or commodity instruments as of October 31, 2009. We are exposed to financial market risks, including changes in interest rates. All borrowings under our Revolving Credit Agreement bear interest at 1.5% below prime rate or a LIBOR-based rate. An increase in interest rates of 100 basis points would not significantly affect our income. All of our business is transacted in U.S. dollars and, accordingly, foreign exchange rate fluctuations have not had a significant impact on us, and they are not expected to in the foreseeable future.

Item 4.

CONTROLS AND PROCEDURES

(a) Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures. As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) under the Securities and Exchange Act of 1934, as amended (the "Exchange Act")). Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Act (15 U.S.C. 78 et seq.) is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Additionally, they concluded that our disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports that the Company is required to file or submit under the Exchange Act is accumulated and communicated to management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures.

(b) Changes in Internal Control over Financial Reporting. There have been no changes during the quarter ended October 31, 2009 in the Company's internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

In July 2008, a lawsuit styled Jessica Chapman, on behalf of herself and others similarly situated, v. FRED'S Stores of Tennessee, Inc. was filed in the United States District Court for the Northern District of Alabama, Southern Division, in which the plaintiff alleges that she and other female assistant store managers are paid less than comparable males and seeks compensable damages, liquidated damages, attorney fees and court costs. The plaintiff filed a motion seeking collective action. Briefs have been filed and oral arguments have been conducted, but the court has not yet ruled. The Company believes that all assistant managers have been properly paid and that the matter is not appropriate for collective action treatment. Discovery has not yet begun. The Company is and will continue to vigorously defend this matter. In accordance with FASB ASC 450, "Contingencies", the Company does not feel that a loss in this matter is probable or reasonably estimated. Therefore, we have not recorded a liability for this case.

In addition to the matters disclosed above, the Company is party to several pending legal proceedings and claims arising in the normal course of business. Although the outcome of the proceedings and claims cannot be determined with certainty, management of the Company is of the opinion that it is unlikely that these proceedings and claims will have a material adverse effect on the financial statements as a whole. However, litigation involves an element of uncertainty. There can be no assurance that pending lawsuits will not consume the time and energy of our management or that future developments will not cause these actions or claims, individually or in aggregate, to have a material adverse effect on the financial statements as a whole. We intend to vigorously defend or prosecute each pending lawsuit.

Item 1A. Risk Factors

The risk factors listed in Part I, "Item 1A. Risk Factors" in the Annual Report on Form 10-K for the fiscal year ended January 31, 2009, should be considered with the information provided elsewhere in this Quarterly Report on Form 10-Q, which could materially adversely affect the business, financial condition or results of operations. There have been no material changes to the risk factors as previously disclosed in such Annual Report on Form 10-K.

Item 6. Exhibits

Exhibits:

31.1	Certification of Chief Executive Officer.
31.2	Certification of Chief Financial Officer.
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to rule 13a–14(b) under the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.

SIGNATURES

Pursuant to the requirements 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.

FRED'S, INC.

Date: December 10, 2009	/s/ Bruce A. Efird Bruce A. Efird Chief Executive Officer and President
Date: December 10, 2009	/s/ Jerry A. Shore Jerry A. Shore Chief Financial Officer