

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 January 28, 2017

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
(State or Other Jurisdiction of
Incorporation or Organization)

62-0634010
(I.R.S. Employer
Identification Number)

4300 NEW GETWELL ROAD
MEMPHIS, TENNESSEE 38118
(Address of Principal Executive Offices)

Registrant's telephone number, including area code (901) 365-8880
Securities Registered Pursuant to Section 12(b) of the Act:

Title of Class
Class A Common Stock, no par value
Share Purchase Rights

Name of exchange on which registered
The NASDAQ Global Select Market

Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes No

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 whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (of for such shorter period that the registrant was required to submit and post such files). 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 a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

Aggregate market value of the voting stock held by non-affiliates of the Registrant, based upon the last reported sale price on such date by the NASDAQ Global Select Market, Inc. on July 30, 2016 the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$427 million. Shares of voting stock held by executive officers, directors and holders of more than 10% of the outstanding voting shares have been excluded from this calculation because such persons may be deemed to be affiliates. Exclusion of such shares should not be construed to indicate that any of such persons possess the power, direct or indirect, to control the Registrant, or that such person is controlled by or under common control of the Registrant.

As of April 7, 2017, there were 37,986,626 shares outstanding of the Registrant's Class A no par value voting common stock.

As of April 7, 2017, there were no shares outstanding of the Registrant's Class B no par value non-voting common stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's Proxy Statement for the 2017 annual stockholders meeting, to be filed within 120 days of the registrant's fiscal year end, are incorporated into Part III of this Annual Report on Form 10-K (the "Form 10-K") by reference. With the exception of those portions that are specifically incorporated herein by reference, the aforesaid document is not to be deemed filed as part of this Form 10-K.

FRED'S, INC.
FORM 10-K
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Cautionary Statement Regarding Forward-looking Information

Other than statements based on historical facts, many of the matters discussed in this Form 10-K 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.A. Sections 77z-2 and 78u-5 (Supp. 1996). The Reform Act created a safe harbor to protect companies from securities law liability in connection with forward-looking statements. Fred's Inc. (“Fred's” or the “Company”) intends to qualify both its written and oral forward-looking statements for protection under the Reform Act and any other similar safe harbor provisions.

The words "outlook", "guidance", "may", "should", "could", “believe”, “anticipate”, “project”, “plan”, “expect”, “estimate”, “objective”, “forecast”, “goal”, “intend”, “will likely result”, or “will 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: (i) the competitive nature of the industries in which we operate; (ii) the implementation of our strategic plan, and its impact on our sales, costs and operations; (iii) utilizing our existing and new stores and increasing our pharmacy department presence in new and existing stores; (iv) our reliance on a single supplier of pharmaceutical products; (v) our pharmaceutical drug pricing; (vi) reimbursement rates and the terms of our agreements with pharmacy benefit management companies; (vii) our private brands; (viii) the seasonality of our business and the impact of adverse weather conditions; (ix) operational difficulties; (x) merchandise supply and pricing; (xi) consumer demand and product mix; (xii) delayed openings and operating new stores and distribution facilities; (xiii) our employees; (xiv) risks relating to payment processing; (xv) our computer system, and the processes supported by our information technology infrastructure; (xvi) our ability to protect the person information of our customers and employees; (xvii) cyber-attacks; (xviii) changes in governmental regulations; (xix) the outcome of legal proceedings, including claims of product liability; (xx) insurance costs; (xxi) tax assessments and unclaimed property audits; (xxii) current economic conditions; (xxiii) changes in third-party reimbursements; (xxiv) the terms of our existing and future indebtedness; (xxv) our acquisitions and the ability to effectively integrate businesses that we acquire; and (xxvi) our ability to pay dividends.

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.

PART I

ITEM 1: Business

General

Fred's, Inc. and its subsidiaries ("Fred's", "We", "Our", "Us" or "Company") was founded in 1947 and operates 628 Company-owned stores, including 55 express stores (or "Xpress" stores) and 3 specialty pharmacy-only locations as of January 28, 2017 in fifteen states primarily in the southeastern United States. In addition to the Company-owned stores, there were 16 franchised stores operating under the Fred's name, three of which have pharmacy departments. Fred's stores generally serve low, middle and fixed income families located in small- to medium-sized towns. There were 362 full-service pharmacies, which are included in the Company-owned and franchise locations. The Company is headquartered in Memphis, Tennessee.

Fred's stores stock over 12,000 items which address the everyday needs of its customers, including nationally recognized brand name products, proprietary "Fred's" label products and lower priced off-brand products. Fred's management believes its customers shop Fred's stores as a result of their convenient locations, consumer friendly sizes, consistent availability of products at everyday low prices, pharmacy department and healthcare services, regularly advertised departmental promotions and seasonal specials. Fred's Company-owned, full-service stores had an average selling space of 14,749 square feet and had average sales of \$3,044,161 in fiscal 2016.

The Company utilizes a 52 - 53 week accounting period which ends on the Saturday closest to January 31. Fiscal years 2016, 2015 and 2014, as used herein, refer to the years ended January 28, 2017, January 30, 2016 and January 31, 2015, respectively. Fiscal years 2016, 2015 and 2014 each had 52 weeks.

Business Strategy

Under the leadership of its new management team, Fred's has embarked on a new healthcare strategy to transform the Company and improve the lives of patients and customers by providing quality healthcare services and consumer products that deliver value and convenience to the communities it serves. This focus on healthcare will rebuild the foundation for the future of Fred's, its team members and shareholders.

As part of its transformation, the Company is rolling out a series of initiatives to lay the groundwork for success and improve performance sequentially. Fred's is:

- Upgrading and developing talent;
- Investing in technology to improve both Pharmacy and Front store processes and efficiencies;
- Improving the patient pharmacist relationship and experience;
- Implementing strategies to grow comp scripts;
- Diversifying and growing its specialty pharmacy portfolio;
- Enhancing stores to improve the customer experience;
- Increasing supply chain efficiencies and reducing costs;
- Expanding Front Store and Pharmacy margins; and
- Optimizing its store portfolio and inventory to improve performance and cash flow.

Fred's strategy is laid out through its three business areas, and the Company has begun to implement process improvements in each that are key to the success of Fred's:

Approximately 73% of our stores are located in markets with populations of 15,000 or less, where Fred's provides often the only, or one of only two, pharmacies in the town or county. We continue to evaluate additional opportunities where expansion exists to further meet the needs of our customers. In 2016, Fred's aligned its leadership and focused its pharmacy organization to drive scripts into our stores, improve service to patients and train teams to ensure a consistent and reliable experience at every store for every patient. The Company has revised its reimbursement strategies, expanded its 340B program and launched store and community-specific marketing campaigns. Additionally the Company initiated a pharmacist outreach program to win back patients, as well as a health services platform. Through Fred's many relationships with hospitals and payors, we will continue to leverage our pharmacists, who are already the most accessible go-to healthcare professionals for a wide variety of preventive care, screening and disease management services. The Company launched a number of programs that it believes will yield long-term sustainable results by improving the patient experience in the store, driving top line sales and script comps, and improving overall pharmacy margins.

In Specialty Pharmacy, Fred's has improved the business through internal reorganization, geographic expansion, and an infusion of new talent that is providing excellent patient service in Hepatitis C, Rheumatology, Multiple Sclerosis, Growth Hormone Therapy, and Oncology. The Company is focused on diversifying and growing its specialty pharmacy portfolio which has resulted in progress in sales trends in the business. Moving forward, the Company will continue to evaluate additional opportunities where expansion of the specialty pharmacy portfolio further meets the needs of customers and patients.

In the front store, Fred's is laying the foundation for success through an emphasis on process improvement, strategic initiatives, training, communication and investments in talent. Fred's has a series of process improvement initiatives that are underway across merchandising to improve processes including category reporting, planograms, off shelf and seasonal planning, circular promotions and joint business planning. The Company has made significant progress implementing a new vendor funding tool, leveraging its new JDA platform to optimize inventory and is continuing to drive increased efficiency in end-to-end supply chain resulting in expense savings.

Growth Strategy

The Company's investments in experienced talent, process, technology and infrastructure are building a foundation for long-term growth, profitability and shareholder value. Along with the strategies discussed in the paragraphs above, Fred's growth strategy also includes its pending acquisition of 865 Rite Aid stores, which would make Fred's the third-largest drugstore chain in the nation and transform the largest regional pharmacy player into a true national competitor. The Company anticipates that acquiring the divested Rite Aid stores in highly attractive markets will further accelerate its healthcare growth strategy and result in a company with enhanced scale and size that combined will be more competitive, and create tremendous benefits for customers and team members.

Regardless of our pending acquisition of Rite Aid stores, the Company will look opportunistically at other potential acquisitions. As part of the Company's continuing operations and based upon ongoing analysis of store performance and expected trends, we periodically evaluate the need to close underperforming stores.

During 2016 Fred's opened one new full service store and one new express location, acquired one franchise location and moved one express pharmacy into an existing full service store. The Company closed 10 full-service locations, 5 express locations and one franchise store. The Company added 5 pharmacies and closed 14 pharmacies. The Company announced the closure of 40 stores in 2016 which are scheduled to close in 2017. The Company's store prototype normally has 14,000 to 16,000 square feet of space and the typical size of an Xpress location ranges from 1,000 to 5,000 square feet. The Company prefers to use developers to construct build-to-suit locations with leases beginning after completion. In certain cases, the Company leases second-generation locations that may alter the size and layout of our typical build-to-suit store.

Fred's "Xpress" Designation: The term "Xpress" refers to our locations that are smaller in square footage and offer pharmacy services along with a scaled-down, convenience-centered general merchandise area. The Xpress designation is simply a way of describing our locations that are atypical to our other full-service stores. These locations range in size from 1,000 to 5,000 square feet, and enable the Company to enter a new market with a more cost effective initial investment. These locations primarily sell pharmaceuticals, other health and beauty related items, and limited general merchandise offerings, mainly consumables. Xpress locations usually originate from a pharmacy acquisition and are in a location that is not suitable for the typical layout of a Fred's store. Therefore, the new store location is given the Xpress designation, and is targeted for conversion to a typical Fred's store once a suitable location can be obtained. In some cases, Xpress locations are located in areas that may not be able to support a full-service store. In all other ways, including resource allocation, management, training, marketing and corporate support, it is treated just as any other location in the Company's network of stores. Given their smaller physical size, however, Xpress locations are not stocked with the full breadth of merchandise in all departments that are carried by the Company's other stores.

Within the population of Xpress locations, acquisitions are routinely being completed and existing Xpress locations are being converted as suitable full-service locations are identified. Xpress sales, as a percentage of total sales, for 2016, 2015 and 2014 were 7.6%, 8.0% and 7.1%, respectively and gross profit, as a percentage of total gross profit, for the same time periods was 7.1%, 7.8% and 7.0%, respectively.

The following tables set forth certain information with respect to stores and pharmacies for each of the last five fiscal years:

	2016	2015	2014	2013	2012
Full-service stores open at the beginning of the year	581	579	630	644	638
Full-service stores opened/acquired	2	3	6	11	20
Full-service stores closed	(10)	(1)	(57)	(25)	(14)
Full-service stores open at the end of the year	573	581	579	630	644
Xpress stores open at the beginning of the year	60	62	53	47	41
Xpress stores opened/acquired	1	6	18	14	15
Xpress stores closed	(5)	(5)	(5)	(5)	-
Xpress stores converted to full-service stores	(1)	(3)	(4)	(3)	(9)
Xpress stores open at the end of the year	55	60	62	53	47
Total Company-owned stores	628	641	641	683	691
Franchise stores at end of period	16	18	19	21	21
Total Fred's retail stores	644	659	660	704	712
Number of stores with pharmacies at the end of the year ⁽¹⁾	362	372	376	361	352
Specialty pharmacy facilities	3	3	1	1	-
Total selling square feet of full-service stores (in thousands)	8,451	8,600	8,536	9,355	9,624
Average selling square feet per full-service store	14,749	14,802	14,743	14,848	14,944

(1) Pharmacies are included in the count of full-service, Xpress and franchise stores.

Merchandising and Marketing

The business in which the Company is engaged is highly competitive. The principal competitive factors include location of stores, 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 national, regional and local retailing establishments, including drug stores, independent pharmacies, department stores, discount stores, variety stores, dollar stores, discount clothing stores, grocery stores, outlet stores, convenience stores, warehouse stores and other stores. Many of the largest retail companies in the nation have stores in areas in which the Company operates. Management believes that its knowledge of regional and local consumer preferences, developed over its 70 year history, enables the Company to compete very effectively within its region.

Management believes that Fred's has a distinctive niche in that it offers a pharmacy department along with a wider variety of merchandise with a more attractive price-to-value relationship than either a drug store or smaller variety/dollar store and is more shopper-convenient than a larger discount store. The variety and depth of merchandise offered in our high-traffic departments, such as health and beauty aids and paper and cleaning supplies, are comparable to those of larger discount retailers.

Purchasing

The Company's primary front store buying activities are directed by the Chief Merchandising and Marketing Officer and three Senior Vice Presidents of Merchandising. The merchandising department is supported by a staff of 35 merchants and assistants, some of which purchase for multiple, similar general merchandise departments. The merchants are participants in an incentive compensation program, which is based upon both individual and total company performance metrics, all of which are designed to drive shareholder value. The Company purchases its merchandise from a wide variety of domestic and import suppliers. Many of the import suppliers generally require long lead times and orders are placed four to six months in advance of delivery. These products are either imported directly by us or acquired from distributors based in the United States and their purchase prices are denominated in United States dollars. The Supply Chain division manages all replenishment and forecasting functions with the Company's proprietary software which generates open-to-buy reports. Each merchandising department develops vendor line reviews and assortment plans and tests new products and programs to continually improve overall inventory productivity and in-stock positions.

In 2016, approximately 3.3% of the Company's total purchases were from Procter and Gamble. Procter and Gamble purchases were 3.5% in 2015 and 5.1% in 2014. The decrease in Procter and Gamble purchases as a percent of total purchases is due to the sales mix shift towards higher dollar specialty pharmaceuticals. The Company believes that adequate alternative sources of products are available for these categories of merchandise.

The Company's prescription drugs are replenished through the pharmacy inventory management system and shipped direct from the Company's primary pharmaceutical wholesaler, Cardinal Health, Inc. ("Cardinal Health"), to the pharmacies five days a week. Cardinal Health provides substantially all of the Company's prescription drugs. On August 6, 2014, the Company entered into a Prime Vendor Agreement with Cardinal Health, replacing the Company's former primary pharmaceutical wholesaler, AmerisourceBergen Corporation ("Bergen"). During 2014 approximately 29% of the Company's total purchases were made from Bergen. During 2016, 2015 and 2014, approximately 50%, 50% and 16%, respectively, of the Company's total purchases were made from Cardinal Health. Although there are alternative wholesalers that supply pharmaceutical products, the Company operates under a purchase and supply contract with Cardinal Health as its primary wholesaler, which continues through March 2018. Accordingly, the unplanned loss of this particular supplier could have a short-term gross margin impact on the Company's business until an alternative wholesaler arrangement could be implemented.

Excluding the purchases made from our pharmaceutical supplier, Cardinal, our former pharmaceutical supplier, Bergen, and those made from Procter and Gamble mentioned previously, no other supplier accounted for more than 5% of the Company's total purchases for 2016, 2015 and 2014.

Sales Mix

The Company's sales, which occur through Company-owned stores and to franchised Fred's stores, constitute a single reportable operating segment.

The Company's sales mix by major category for the preceding three years was as follows:

	For the Years Ended		
	January 28, 2017	January 30, 2016	January 31, 2015
Pharmacy	51.4%	50.2%	41.9%
Consumables	24.5%	25.7%	31.2%
Household Goods and Softlines	22.9%	22.6%	25.3%
Franchise	1.2%	1.5%	1.6%
Total Sales Mix	100.0%	100.0%	100.0%

While the sales mix for the Company overall is 51.4% pharmacy, up from 50.2% in 2015, the sales mix varies from store to store depending upon local consumer preferences and whether the stores include pharmacy departments or the Company's full product line offerings. In 2016, the average customer transaction size for comparable stores was approximately \$25.28, and the number of customer transactions totaled approximately 81 million. The average transaction size was approximately \$23.01 in 2015 and \$21.94 in 2014, and the customer transactions totaled approximately 82 million in 2015 and 84 million in 2014. The increase in average transaction size is mainly due to an increase penetration of high ticket specialty pharmacy sales.

Fred's Brand products include health, beauty and personal care products, household cleaning supplies, disposable diapers, pet foods, paper products and a variety of food and beverage products. Private label products afford the Company higher than average gross margins while providing the customer with lower priced products that are of a quality comparable to that of competing branded products. An independent laboratory-testing program is used for substantially all of the Company's private label products. As part of our own brand initiative, we expanded our private label program in 2015 to include additional over-the-counter healthcare products and consumables and continued this expansion in 2016.

The Company sells merchandise to its 16 franchised Fred's stores. These sales totaled approximately \$25.6 million in 2016, \$31.5 million in 2015 and \$31.5 million in 2014. Franchise and other fees earned totaled approximately \$1.2 million in 2016, \$1.5 million in 2015 and \$1.5 million in 2014. These fees represent a reimbursement for use of the Fred's name and administrative costs incurred on behalf of the franchised stores. One franchise location was purchased by the Company from a franchisee in 2016 and one location was closed. The Company does not intend to expand its franchise network.

Advertising and Promotions

Net advertising and promotion costs represented approximately 1.0% of net sales in 2016 and 0.9% in 2015, compared to 1.1% in 2014. The Company uses direct mail, newspaper, email and social media advertising to deliver the Fred's value message. The Company utilizes full-color circulars coordinated by our internal advertising staff to promote its merchandise, special promotional events and a discount retail image. Additionally, the Company retains an outside advertising agency to assist with digital advertising, and to develop and implement the Company's branding strategy.

The Company executes, through its store managers, impactful in-store advertising displays and signage in order to increase impulse purchases. The Company also offers clearance events of seasonal merchandise and conducts sales and promotions of particular items.

Store Operations

Fred's stores are open seven days a week and store hours at most locations are from 8:00 a.m. to 9:00 p.m. Pharmacy departments typically close at 7:00 pm Monday through Saturday and are closed all day on Sunday. Each Fred's store is managed by a full-time store manager and those stores with a pharmacy employ a pharmacist-in-charge, who manages the pharmacy department within the store. The Company's district managers, Regional Vice Presidents and Executive Vice President of Store Operations supervise the management and operation of Fred's stores.

As of January 28, 2017, Fred's operates 362 retail pharmacies and three specialty pharmacy only locations, which offer brand name and generic pharmaceuticals and are staffed by licensed pharmacists. The Company's healthcare managers, Vice Presidents, Regional Vice Presidents, Senior Vice Presidents and Executive Vice President, Chief Operating Officer manage and supervise the operation of Fred's pharmacy departments. The addition of pharmacy departments in the Company's stores has resulted in increased store sales and sales per selling square foot. Management believes that the pharmacy department, in addition to the 42 other general merchandise departments, increases customer traffic and repeat visits and is an integral part of the store's operation and a key differentiating factor from our discount store competitors.

The Company has an incentive compensation plan for store managers, pharmacists, district managers and healthcare managers based on targeted profit goals. Among the factors included in determining profit goals are gross profits and controllable expenses at the store level. These factors of operating performance are reviewed regularly by executive management. Management believes that this incentive compensation plan, together with the Company's store management training program, are instrumental in maximizing store performance. The Company's training program covers all aspects of the Company's operation from product knowledge to handling customers with courtesy.

Inventory Control

The Company's centralized management information system maintains a daily stock-keeping unit ("SKU") level inventory and current and historical sales information for each store and the distribution centers. This system is supported by our in-store point-of-sale ("POS") system, which captures SKU and other data at the time of sale. In 2015, the Company partnered with JDA Software Group, Inc. for a multi-year implementation of a new replenishment, allocation and space management planning system to significantly enhance and streamline those processes. The Company also utilizes OrderInsite, a pharmacy inventory management system designed to optimize our inventory and improve our in-stock position on pharmaceuticals. Additionally, the Company uses NEX/DEX technology for in-store receiving and inventory control for all items delivered directly to our stores. The Company conducts annual physical inventory counts at all Fred's stores and has implemented the use of radio frequency devices ("RF guns") to conduct cycle counts to ensure replenishment accuracy.

Distribution

The Company has an 850,000 square foot distribution center in Memphis, Tennessee that services 314 stores and a 600,000 square foot distribution center in Dublin, Georgia that services 314 stores (see Item 2: "Properties"). Approximately 33% of the general merchandise received by Fred's stores in 2016 was shipped through these distribution centers, with the remainder (primarily pharmaceuticals, certain snack food items, greeting cards, beverages, frozen foods and tobacco products) shipped directly to the stores by suppliers. For distribution, the Company uses owned and leased trailers and tractors, as well as common carriers. The Company's warehouse management system is automated and provides conveyor control and pick, pack and ship processes by using portable radio-frequency terminals. This system is integrated with the Company's centralized management information system to provide up-to-date perpetual records as well as facilitating merchandise allocation and distribution decisions. The Company uses weekly cycle counts throughout the year to ensure accuracy within the warehouse management system. The Company also began utilizing a new store replenishment system called JDA that replenishes on a by-store by-item basis for the first time in company history to improve merchandise in-stock status.

Payment Cycles and Seasonality

Our business is subject to both monthly and seasonal sales shifts. The Company's sales volume is heavier around the first day of each calendar month due to the fact many of the customers who shop at Fred's stores rely on government aid, social security, and other means that are typically paid around this time. These governmental payment cycles, coupled with the concurrent distribution of our direct and shared mail advertising, are major factors in concentrating sales earlier in the calendar month. Sales are also impacted by the holiday selling season and the timing and severity of the cough, cold and flu season. We typically experience highest sales in the first and fourth quarters as a result.

The following table reflects the payment cycles and seasonality of net sales by quarter:

For the year ended:	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
January 28, 2017				
Net Sales	25.9%	24.9%	24.3%	24.9%
January 30, 2016				
Net Sales	23.7%	25.4%	25.1%	25.8%
January 31, 2015				
Net Sales	25.3%	24.9%	24.2%	25.6%

Our quarterly results can also be affected by the timing of certain holidays and by store openings and closings. Higher volumes of inventory are purchased in the third quarter in preparation for higher traffic and sales volume in the fourth quarter.

Employees

As of January 28, 2017, the Company had 4,832 full-time and 4,984 part-time employees, the majority of which are store employees. The number of employees varies during the year, reaching a peak during the Christmas selling season, which typically begins after the Thanksgiving holiday. The Memphis, Tennessee distribution center employees are represented by a union, UNITE-HERE, pursuant to a three year collective bargaining agreement which went into effect on July 1, 2014. The Company believes that it continues to have good relations with all of its employees.

Competition

The retail pharmacy business is highly competitive. We compete with respect to price, store location, in-stock consistency, merchandise quality, assortment and presentation, and customer service with many national, regional and local retailing establishments, including drug stores, independent pharmacies, department stores, discount stores, variety stores, dollar stores, discount clothing stores, grocery stores, outlet stores, convenience stores, warehouse stores and other stores. Our competitors range from smaller, growing companies to considerably larger retail businesses that have greater financial, distribution, marketing and other resources than we do. There is no assurance that we will be able to compete successfully with them in the future. See "Cautionary Statement Regarding Forward-Looking Information" and Item 1A: "Risk Factors."

Government Regulation

As a publicly-traded company, we are subject to numerous federal securities laws and regulations, including the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, and related rules and regulations promulgated by the Securities and Exchange Commission ("SEC"), as well as the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Wall Street Reform and Consumer Protection Act. These laws and regulations impose significant requirements in the areas of accounting and financial reporting, corporate governance and insider trading, among others.

Each of our locations must comply with regulations adopted by federal and state agencies regarding licensing, health, sanitation, safety, fire and other regulations. In addition, we must comply with the Fair Labor Standards Act, as amended, and various state laws governing various matters such as minimum wage, overtime and other working conditions. We must also comply with provisions of the Americans with Disabilities Act of 1990, as amended, which requires generally that employers provide reasonable accommodation for employees with disabilities and that our stores be accessible to customers with disabilities. The Company's pharmacy department, in particular, is subject to extensive federal and state laws and regulations.

Licensure and Regulation of Retail Pharmacies

There are extensive federal and state regulations applicable to the practice of pharmacy at the retail level. We are subject to numerous federal and state laws and regulations concerning the protection of confidential patient medical records and information, including the federal Health Insurance Portability and Accountability Act (“HIPAA”). Most states have laws and regulations governing the operation and licensing of pharmacies, and regulate standards of professional practice by pharmacy providers. These regulations are issued by an administrative body in each state, typically a pharmacy board, which is empowered to impose sanctions for non-compliance. Specialty pharmacies differ in the fact they carry multiple state licenses, something typically not seen with retail pharmacies. Additionally, the Drug Enforcement Agency (“DEA”) requires that controlled substances be monitored and controlled at all times.

Our business is also subject to federal, state and local laws, regulations, and administrative practices concerning the provision of and payment for health care services, including, without limitation: federal, state and local licensure and registration requirements concerning the operation of pharmacies and the practice of pharmacy; Medicare, Medicaid and other publicly financed health benefit plan regulations prohibiting kickbacks, beneficiary inducement and the submission of false claims.

As a provider of Medicare prescription drug plan benefits, we are subject to various federal regulations promulgated by the Centers for Medicare and Medicaid Services under the Medicare Prescription Drug, Improvement and Modernization Act of 2003. In the future we may also be subject to changes to various state and federal insurance laws and regulations in connection with the Company’s pharmacy operations.

Healthcare Initiatives

Legislative and regulatory initiatives pertaining to such healthcare related issues as reimbursement policies, payment practices, therapeutic substitution programs, and other healthcare cost containment issues are frequently introduced at both the state and federal levels. In March 2010, the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act (collectively, the “PPACA”), was enacted, but we did not experience a material impact to our business. This PPACA legislation made it possible for states to expand their Medicaid rolls, but many chose not to exercise their expansion ability under the new legislation. The majority of any incremental pharmacy business generated under the healthcare exchanges created by PPACA has been assimilated into our traditional commercial payor networks.

Some of the provisions of the PPACA have yet to be implemented, and there have been judicial and Congressional challenges to certain aspects of the PPACA. In addition, the current administration and Congress will likely continue to seek legislative and regulatory changes, including repeal and replacement of certain provisions of the PPACA. In January 2017, President Trump signed an Executive Order directing federal agencies with authorities and responsibilities under the PPACA to waive, defer, grant exemptions from, or delay the implementation of any provision of the PPACA that would impose a fiscal or regulatory burden on states, individuals, healthcare providers, health insurers, or manufacturers of pharmaceuticals or medical devices. In March 2017, following the passage of the budget resolution for fiscal year 2017, the U.S. House of Representatives introduced legislation known as the American Health Care Act, which, if enacted, would have amended or repealed significant portions of the PPACA. However, consensus over the scope and content of the American Health Care Act could not be reached by its proponents in the U.S. House of Representatives. Thus, the proposed legislation has been withdrawn and the prospects for legislative action on this bill are uncertain. Congress could consider other legislation to repeal or replace certain elements of the PPACA. At this time, we continue to evaluate the effect that the PPACA, and the impact of its possible repeal and replacement has on our business.

Substantial Compliance

The Company’s management believes the Company is in substantial compliance with all existing statutes and regulations material to the operation of the Company’s businesses and is unaware of any material non-compliance action against the Company.

Environmental Matters

We are not aware of any federal, state or local environmental laws or regulations that will materially affect our earnings or competitive position, or result in material capital expenditures. However, we cannot predict the effect on our operations of possible future environmental legislation or regulations. During fiscal year 2016, we did not incur any material capital expenditures for environmental control facilities, and no such material expenditures are anticipated.

Asset Purchase Agreement

On December 19, 2016, Fred's and its wholly-owned subsidiary, AFAE, LLC ("Buyer"), entered into an Asset Purchase Agreement (the "Asset Purchase Agreement") with Rite Aid Corporation ("Rite Aid") and Walgreens Boots Alliance, Inc. ("Walgreens"), pursuant to which Buyer agreed to purchase 865 stores, certain intellectual property and other tangible assets (collectively, the "Assets") and to assume certain liabilities for a cash purchase price of \$950 million (the "Rite Aid Transaction").

Fred's is working collaboratively with Walgreens, Rite Aid and the Federal Trade Commission ("FTC") to help obtain the FTC's approval of Walgreen's pending acquisition of Rite Aid and the divestiture of certain Rite Aid assets to Fred's. Fred's remains committed to purchasing additional assets, including up to 1,200 Rite Aid stores, to the extent necessary to obtain the FTC's approval of the Rite Aid Transaction. Completion of the Rite Aid Transaction is subject to approval by the FTC, as well as other customary regulatory approvals and closing conditions.

The proposed acquisition of the stores, which are based in highly attractive markets, is a transformative event that will add substantial scale to the Company and make Fred's an even stronger competitor and the third-largest drugstore chain in the nation. The Rite Aid Transaction will accelerate the Company's healthcare growth strategy, generating considerable benefits for our customers, patients, payors, supplier partners, team members and shareholders.

More information regarding the Asset Purchase Agreement and the Rite Aid Transaction is available in the Company's Current Report on Form 8-K, filed with the SEC on December 20, 2016, and in certain of the Company's other reports subsequently filed with the SEC.

Available Information

Our website address is <http://www.fredsinc.com>. We make available through this website, without charge, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports as soon as reasonably practicable after these materials are electronically filed with or furnished to the SEC. Also included free of charge on our website is the Company's Code of Business Conduct and Ethics, Vendor Code of Conduct and our Board of Director's committee charters. Alternatively, the public may read and copy any of the materials the Company files with the SEC at the SEC's Public Reference Room, at 100 F Street, NE, Washington DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains a website at <http://www.sec.gov> that contains reports, proxy and information statements and other information regarding issuers, such as Fred's, that file electronically with the SEC.

Sections omitted

ITEM 2: Properties

As of January 28, 2017, the geographical distribution of the Company's 628 stores in 15 states was as follows:

<u>State</u>	<u>Number of Stores</u>
Mississippi	126
Georgia	103
Tennessee	85
Alabama	80
Arkansas	66
Louisiana	64
South Carolina	37
North Carolina	18
Kentucky	15
Texas	14
Florida	6
Missouri	6
Illinois	5
Oklahoma	2
Indiana	1
	<u>628</u>

The Company owns the real estate and the buildings for 88 locations, of which five are closed and six are leased to other tenants. Of the 77 operational Company-owned stores for which the Company owns the real estate and buildings, five stores are subject to ground leases. Two of these locations are encumbered by mortgages (see Note 3 – Indebtedness). The Company leases the remaining 551 Company-owned store locations from third parties pursuant to leases that provide for monthly rental payments primarily at fixed rates (although a number of leases provide for contingent rent, which is additional rent based on sales). Store locations range in size from 1,000 to 5,000 square feet for Xpress locations and 8,000 to 25,000 square feet for full-service stores. Of the 551 locations we lease from third parties, 255 are in strip centers or adjacent to a downtown-shopping district, with the remainder being freestanding.

It is anticipated that existing buildings and buildings to be developed by others will be available for lease to satisfy the Company's new store openings in the near term. It is management's intention to enter into leases of relatively moderate length with renewal options, rather than entering into long-term leases. The Company will thus have maximum relocation flexibility in the future, since continued availability of existing buildings is anticipated in the Company's market areas.

The Company owns its distribution center and corporate headquarters situated on approximately 60 acres in Memphis, Tennessee. The site contains approximately 850,000 square feet of distribution center space, and 250,000 square feet of office and retail space. Presently, the Company uses 90,000 square feet of office space and 22,000 square feet of retail space at the site. The retail space is operated as a Fred's full-service store and is used to test new products, merchandising ideas and technology. The Company financed the construction of its 600,000 square foot distribution center in Dublin, Georgia with taxable industrial development revenue bonds issued by the City of Dublin and County of Laurens Development Authority. Presently, both distribution centers are able to serve a combined total of approximately 1,000 to 1,100 stores.

Sections omitted