**ITEM 1. BUSINESS.**

General

Dillard's, Inc. (the "Company" or "Registrant") is an outgrowth of a department store originally founded

in 1938 by William Dillard. The Company was incorporated in Delaware in 1964. The Company operates

retail department stores located primarily in the southwest, southeast and midwest.

The department store business is highly competitive. The Company has several competitors at the national

and regional levels as well as numerous competitors at the local level. Many factors enter into

competition for the consumer's patronage, including price, quality, style, service, product mix,

convenience and credit availability. The Company's earnings depend to a significant extent on the

results of operations for the last quarter of its fiscal year. Due to holiday buying patterns, sales for

that period average approximately one-third of annual sales.

For additional information with respect to the Registrant's business, reference is made to information

contained on page 12 of the Report under the headings "Net Sales", "Net Income", "Total Assets" and

"Number of Employees-Average", which information is incorporated herein by reference.

**ITEM 2. PROPERTIES.**

All of the Registrant's stores are owned or leased from a wholly owned subsidiary or from third parties.

The Registrant's third-party store leases typically provide for rental payments based on a percentage of

net sales with a guaranteed minimum annual rent, while lease terms between the Registrant and its

wholly-owned subsidiary vary. In general, the Company pays the cost of insurance, maintenance and any

increase in real estate taxes related to the leases. At February 3, 2001 there were 337 stores in

operation with gross square footage approximating 56.5 million feet. The Company owns or leases, from a

wholly owned subsidiary, a total of 250 stores with 41.6 million square feet. The Company leased 87

stores from third parties, which totaled 14.9 million square feet. Additional information is contained

in Notes 2, 12 and 13, "Notes to Consolidated Financial Statements," on pages 24, 25, and 29 of the

Report, which information is incorporated herein by reference.

**ITEM 3. LEGAL PROCEEDINGS.**

The Company does not have any material legal proceedings pending.

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

None

Executive Officers of the Registrant

The following table lists the names and ages of all Executive Officers of the registrant, the nature of

any family relationship between them, and all positions and offices with the Registrant presently held by

each person named. All of the Executive Officers listed below have been in managerial positions with the

registrant for more than five years, except for Robin Sanderford, Paul J. Schroeder, Jr. and Charles

Unfried.

Mr. Sanderford has been employed by the Registrant as Vice President since August 1998. Prior to August

1998 he was employed as President of the Southeast Division of Mercantile Stores Company, Inc.

("Mercantile") (1995-1998) and as Vice President and Director of Real Estate and Long Range Planning for

Mercantile (1993-1995). Mr. Schroeder has been employed by the Registrant as Vice President since January

1998. Prior to 1998 he was a partner with the St. Louis based, international law firm of Bryan Cave,

LLP, specializing in labor and employment law. Mr. Unfried has been employed by the Registrant since

August 1998. Prior to August 1998 he was President of Mercantile Credit Services and Mercantile Stores

National Bank, both subsidiaries of Mercantile.

**ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.**

With respect to the market for the Company's common stock, market prices, and dividends, reference is

made to information contained on page 33 of the Report, which information is incorporated herein by

reference. As of March 30, 2001, there were 5,127 record holders of the Company's Class A Common Stock

and 8 record holders of the Company's Class B Common Stock.

**ITEM 6. SELECTED FINANCIAL DATA.**

Reference is made to information under the heading "Table of Selected Financial Data" on page 12 of the

Report, which information is incorporated herein by reference.

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

Reference is made to information under the heading "Management's Discussion and Analysis of Financial

Condition and Results of Operations" on pages 13 through 16 of the Report, which information is

incorporated herein by reference.

During fiscal 1998, the Company completed its acquisition (the “Acquisition”) of Mercantile Stores Company, Inc. (“Mercantile”) for approximately $3 billion in cash. Mercantile was a conventional department store retailer engaged in the general merchandising business, operating 106 department and home fashion stores under 13 different names in a total of 17 states.

The Acquisition was accounted for under the purchase method and, accordingly, the results of operations have been included in the Company’s results of operations since August 13, 1998, and the purchase price was allocated to Mercantile’s assets and liabilities based on their estimated fair values as of that date. The excess of cost over net assets acquired was approximately $666 million.

In connection with the Acquisition, the Company entered into two separate agreements whereby the Company sold in the aggregate 26 of the acquired stores to Proffitt’s, Inc. and The May Department Stores Company. In addition, the Company entered into an agreement with Belk, Inc. to exchange seven of the acquired stores for nine Belk, Inc. stores. The results of operations of the sold or exchanged stores are included in the accompanying statements of operations from the date of acquisition to the date of sale or exchange.

Sales

Sales decreased 1% for the 53-week period ended February 3, 2001 compared to the 52-week period ended January 29, 2000. Sales for the 52-week period ended January 27, 2001 decreased 3% from 1999 on both a total and comparable store basis. Sales declined in all merchandise categories with the exception of cosmetics. The weakest performing merchandise categories were women’s and juniors’ clothing and home sales which decreased 4%. Sales increases were 12% and 17% for 1999 and 1998, respectively. The sales increase in 1999 is due to a full year of sales generated by stores acquired in the Acquisition as well as incremental revenue from traditional store openings. Comparable store sales increases were 3% and 1% for 1999 and 1998, respectively. Comparable store sales include sales for those stores which were in operation for a full period in both the current month and the corresponding month for the prior year. Management believes that the majority of the change in sales in comparable stores was attributable to a change in the volume of goods sold rather than a change in the price of goods.

Cost of sales as a percentage of sales was 67.8% and 66.4% in 2000 and 1999, respectively. The increase in cost of sales as a percentage of net sales was due to (i) sluggish consumer demand in the broadline retail sector resulting in increased promotional activity to clear seasonal merchandise; (ii) the Company’s enhanced markdown strategy to accelerate markdowns and shorten merchandise cycles;(iii) continued non-acceptance of specific lines of branded merchandise; and (iv) continued focus on reducing inventory investment.

During the fall season of 2000, the Company began the implementation of an enhanced markdown strategy that accelerates markdowns and shortens merchandise cycles. Principally due to this initiative, the Company’s total markdowns during fiscal 2000 exceeded those of the prior year by approximately $434 million or 5.1% of sales.

Effective January 30, 2000, the Company changed its method of accounting for inventories under the retail inventory method. The change principally relates to the Company’s accounting for vendor markdown allowances, from recording these allowances directly as a reduction of cost of sales to recording such allowances as a reduction of inventoriable product cost. Historically, the vendor/retailer arrangement provided for the Company to receive allowances from vendors when gross margin rates fell below stipulated levels. During fiscal 2000, the Company and certain vendors revised the vendor/retailer arrangement whereby the vendors are providing up-front allowances in the form of a fixed percentage discount off of purchases. The Company views the changes in the vendor arrangements as a new purchasing model that will enhance its merchandising decisions. Since the vendor allowances are directly related to purchases, the Company accounts for such fixed discount arrangements as a reduction of inventoriable product cost. As the Company moves toward the new purchasing model, it plans to continue to negotiate up-front discounts with its vendors. As such, the Company is no longer viewing vendor markdown allowances as direct reductions of markdowns, but rather as overall vendor discounts on inventory purchases, along with the up-front product discounts noted above. Accordingly, the Company has changed its accounting method for markdown allowances to record such allowances as a reduction of inventoriable product cost. In addition, and as a result of this change, the Company has also changed its method of accounting for certain retail price adjustments, from recording such price adjustments as a reduction of initial mark-up to recording them as markdowns under the retail inventory method. The Company believes that its change in accounting method will result in improved merchandising and buying decisions. The cumulative effect of the accounting change as of January 30, 2000 was to decrease net income for fiscal year 2000 by $130 million, net of tax, or $1.42 per share. The effect of adopting the new method was to increase both income before extraordinary item and net income for fiscal 2000 in the amount of $30 million ($.33 per share).

Cost of sales as percentage of sales was 66.4% and 66.8% for 1999 and 1998, respectively. Cost of sales for 1998 includes a charge of $39 million resulting from alignment of Mercantile inventories to reflect the Company’s merchandising and pricing philosophy. Prior to this charge, cost of sales, as a percent of net sales, would have been 66.3%, for 1998. Additionally, during the fourth quarter of 1998, the Company experienced significant merchandise processing and distribution delays due to systems integration problems during the consolidation of Dillard’s and Mercantile distribution systems. The delays resulted in later than planned store receipts and subsequent higher levels of markdowns in the post-holiday selling season.

Expenses

Advertising, selling, administrative and general (“SG&A”)expenses were 25.9% of sales for fiscal 2000 compared to 25.4% for fiscal 1999. The increase as a percentage of sales for fiscal 2000 is attributable to lower than planned sales levels which negatively impacted the Company’s leverage of fixed SG&Acosts. In addition, the increase was attributable to higher advertising and services purchased, partially offset by reduced bad debt expenses during fiscal 2000. Depreciation and amortization as a percentage of sales increased slightly during fiscal 2000 principally due to the 3% decline in comparable store sales during the year. Interest and debt expense as a percentage of sales declined during fiscal 2000 as a result of the Company’s focus on reducing its outstanding debt levels (see Liquidity and Capital Resources).

SG&Aexpenses were 25.4% of sales for fiscal 1999 compared to 26.7% in fiscal 1998. Included in fiscal 1998 results were certain business integration and consolidation expenses associated with the integration of Mercantile into the Company. Such expenses included $43 million of severance costs, $26 million of lease rejection costs for facilities closed subsequent to the Acquisition, and $22 million of costs associated with operating Mercantile central office functions for a transitional period. Excluding such charges, SG&Aexpenses as a percentage of sales were comparable for fiscal 1999 and 1998. Depreciation and amortization expenses as a percentage of sales increased from fiscal 1998 to fiscal 1999 primarily due to the amortization of goodwill resulting from the Acquisition in 1998. The increase in interest and debt expense as a percentage of sales from fiscal 1998 to fiscal 1999 resulted from the additional borrowings incurred in connection with the Acquisition in 1998.

During the fourth quarter of 2000, the Company recorded a pre-tax charge of $51 million for asset impairment and store closing costs. The charge includes a write-down to fair value for certain under-performing properties in the amount of $37 million, and exit costs to close four such properties in the amount of $14 million. The Company does not expect to incur significant additional exit costs upon the closing of these properties in fiscal 2001. During fiscal 1999, the Company recorded a pre-tax asset impairment charge of $70 million related to the write-down to fair value of eight under-performing properties, all of which were closed during fiscal 2000.

Income Taxes

The Company’s actual federal and state income tax rate (exclusive of the effect of nondeductible goodwill amortization) was reduced from 37% in fiscal 1999 to 36% in fiscal 2000, as a result of lower effective combined income tax rates. The effect of these reduced rates on the Company’s deferred income taxes was to reduce the income tax provision by $16 million in fiscal 2000.

Liquidity and Capital Resources

Net cash flows from operations were $797 million for 2000 and were adequate to fund the Company’s operations for the year. During 2000, the Company reduced its level of outstanding debt by $420 million through scheduled debt maturities and repurchases of notes prior to their related maturity dates. Capital expenditures were $226 million for 2000. During 2000, the Company constructed seven new stores (three of which were replacement stores).

During 2000, the Company continued its focus on reducing its inventory levels and improving its inventory turnover. As a result, merchandise inventories decreased by $229 million during 2000. On a comparable store basis, the merchandise inventories decreased by 13%. The Company’s accounts receivable decreased 11% from the prior year. The decrease relates to declines of private label credit sales as well as improved collections.

During 2000, the Company repurchased $211 million of its outstanding unsecured notes prior to their related maturity dates. Interest rates on the repurchased securities ranged from 6.1% to 9.5%. Maturity dates ranged from 2003 to 2027. These securities were repurchased at an average yield of 11.4%. The Company also retired $100 million of its 6.08% Reset Put Securities due August 1, 2010 prior to their maturity dates. In connection with these transactions, the Company recorded an extraordinary gain of $27.3 million (net of income taxes of $15.4 million).

In September 1999, the Company announced that the Board of Directors had authorized the implementation of a Class A common share repurchase program of up to $250 million. During the year ended February 3, 2001, the Company repurchased approximately $82 million of Class A Common Stock, representing 5.2 million shares at an average price of $15.80 per share, completing the total purchases authorized under the share repurchase program.

Additionally, in May 2000, the Company announced that the Board of Directors authorized the repurchase of up to $200 million of its Class A Common Stock. During the year ended February 3, 2001, the Company repurchased approximately $102 million of Class A Common Stock, representing 8.7 million shares at an average price of $11.74 per share.

For 2001, the Company plans to construct seven stores totaling 1.38 million square feet and expand three additional stores totaling 202,000 square feet. Capital expenditures are projected to be approximately $225 million for 2001. Maturities of the Company’s long-term debt over the next five years are $209 million, $110 million, $155 million, $199 million and $103 million, respectively.

The Company and its wholly owned finance subsidiary, Dillard Investment Company, have a revolving line of credit in the amount of $750 million. The revolving line of credit requires that consolidated stockholders’ equity be maintained at $1 billion or more. No funds were borrowed under the revolving line of credit during fiscal 2000. At the end of fiscal 2000, the Company had an outstanding shelf registration for securities in the amount of $750 million.

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

Reference is made to information under the heading "Quantitative and Qualitative Disclosures About Market

Risk" on page 16 of the Report which information is incorporated herein by reference.

The table above provides information about the Company's obligations that are sensitive to changes in interest rates. The table presents maturities of the Company's long-term debt and Guaranteed Beneficial Interests in the Company's Subordinated Debentures along with the related weighted average interest rates by expected maturity dates. During the year ended February 3, 2001, the Company repurchased $211.4 million of its outstanding unsecured notes prior to their related maturity dates. Interest rates on the repurchased securities ranged from 6.1% to 9.5%. Maturity dates ranged from 2003 to 2027. The Company also retired $100 million of its 6.08% Reset Put Securities due August 1, 2010 prior to their maturity date. New Accounting Pronouncements In June 1998, Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133") was issued. In June 2000, Statement of Financial Accounting Standards No. 138, "Accounting for Certain Derivative Instruments and Hedging Activities, an Amendment of FASB Statement No. 133" ("SFAS 138") was issued. SFAS 133 and SFAS 138 address the accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and hedging activities. The Company is required to adopt SFAS 133 and SFAS 138 in the first quarter of 2001. The Company anticipates that the adoption of SFAS 133 and SFAS 138 as of February 4, 2001 will not have a material effect on its financial position or results of operations. In September 2000, the FASB issued SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." SFAS No. 140, which replaces SFAS No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," provides accounting and reporting standards for securitizations and other transfers of assets. The Standard is based on the application of a financial components approach that focuses on control, and provides consistent standards for distinguishing transfers of financial assets that are sales from transfers that are secured borrowings. The Standard requires disclosure of information about securitized assets, including principal outstanding of securitized and other managed assets, accounting policies, key assumptions related to the determination of the fair value of retained interests, delinquencies and credit losses. These disclosures are included in Note 15. The accounting requirements of the Standard are effective for transfers and servicing of financial assets and extinguishments of liabilities occurring after March 31, 2001, and must be applied prospectively. Early adoption of the new rules is not allowed. The Company does not expect the application of SFAS No. 140 to be material to its financial position or results of operations. Forward-Looking Information The Company cautions that any forward-looking statements (as such term is defined in the Private Securities Litigation Reform Act of 1995) contained in this report, the Company's annual report on Form 10-K or made by management of the Company, involve risks and uncertainties and are subject to change based on various important factors. Independent Auditors' Report To the Stockholders and Board of Directors of Dillard's, Inc. Little Rock, Arkansas We have audited the accompanying consolidated balance sheets of Dillard's, Inc. and subsidiaries as of February 3, 2001 and January 29, 2000, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended February 3, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted within the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. In our opinion, such consolidated financial statements present fairly, in all material respects, the consolidated financial position of Dillard's, Inc. and subsidiaries as of February 3, 2001 and January 29, 2000, and the results of their operations and their cash flows for each of the three years in the period ended February 3, 2001 in conformity with accounting principles generally accepted in the United States of America. As discussed in Note 1 to the consolidated financial statements, the Company changed its method of accounting for merchandise inventories under the retail inventory method in 2000. Deloitte &Touche LLP New York, New York March

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

Reference is made to the consolidated financial statements and notes thereto included on pages 18 through

31 of the Report, which are incorporated herein by reference.

See notes to consolidated financial statements. Notes to Consolidated Financial Statements

1. Description of Business and Summary of Significant Accounting Policies

Description of Business $#151; Dillard’s, Inc. (the “Company”) operates retail department stores located primarily in the Southeastern, Southwestern and Midwestern areas of the United States. The Company’s fiscal year ends on the Saturday nearest January 31 of each year. Fiscal years 2000, 1999 and 1998 ended on February 3, 2001, January 29, 2000 and January 30, 1999, respectively. Fiscal year 2000 included 53 weeks and fiscal years 1999 and 1998 included 52 weeks.

Consolidation $#151; The accompanying consolidated financial statements include the accounts of Dillard’s, Inc. and its wholly owned subsidiaries. Intercompany accounts and transactions are eliminated in consolidation. Investments in and advances to joint ventures in which the Company has a 50% ownership interest are accounted for by the equity method.

Use of Estimates $#151; The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash Equivalents $#151; The Company considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents.

Accounts Receivable $#151; Customer accounts receivable are classified as current assets and include some which are due after one year, consistent with industry practice. Credit card receivables are shown net of an allowance for uncollectible accounts. The Company provides an allowance for uncollectible accounts based on impaired accounts, historical charge-off patterns and management judgment. The Company’s current credit processing system charges off an account automatically when a customer’s account becomes six payments delinquent. Finance charge revenue is recorded until an account is charged off, at which time uncollected finance charge revenue is recorded as a reduction of credit revenues.

At February 3, 2001 and January 29, 2000, the LIFO cost of merchandise was approximately equal to the first-in, first-out ("FIFO") cost of merchandise. Effective January 30, 2000, the Company changed its method of accounting for inventories under the retail inventory method. The change principally relates to the Company's accounting for vendor markdown allowances, from recording these allowances directly as a reduction of cost of sales to recording such allowances as a reduction of inventoriable product cost. Historically, the vendor/retailer arrangement provided for the Company to receive allowances from vendors when gross margin rates fell below stipulated levels. During fiscal 2000, the Company and certain vendors revised the vendor/retailer arrangement whereby the vendors are providing up-front allowances in the form of a fixed percentage discount off of purchases. The Company views the changes in the vendor arrangements as a new purchasing model that will enhance its merchandising decisions. Since the vendor allowances are directly related to purchases, the Company accounts for such fixed discount arrangements as a reduction of inventoriable product cost. As the Company moves toward the new purchasing model, it plans to continue to negotiate up-front discounts with its vendors. As such, the Company is no longer viewing vendor markdown allowances as direct reductions of markdowns, but rather as overall vendor discounts on inventory purchases, along with the up-front product discounts noted above. Accordingly, the Company has changed its accounting method for markdown allowances to record such allowances as a reduction of inventoriable product cost. In addition, and as a result of this change, the Company has also changed its method of accounting for certain retail price adjustments, from recording such price adjustments as a reduction of initial mark-up to recording them as markdowns under the retail inventory method. The Company believes that its change in accounting method will result in improved merchandising and buying decisions. The cumulative effect of the accounting change as of January 30, 2000 was to decrease net income for fiscal year 2000 by $130 million, net of tax, or $1.42 per share. The effect of adopting the new method was to increase both income before extraordinary item and net income for fiscal 2000 in the amount of $30 million ($.33 per share). Property and Equipment $#151; Property and equipment owned by the Company is stated at cost, which includes related interest costs incurred during periods of construction, less accumulated depreciation and amortization. Capitalized interest was $4.7 million, $5.2 million and $3.1 million in fiscal 2000, 1999 and 1998, respectively. For tax reporting purposes, accelerated depreciation or cost recovery methods are used and the related deferred income taxes are included in noncurrent deferred income taxes in the consolidated balance sheets. The properties under capital leases and leasehold improvements under operating leases are amortized on the straight-line method over the shorter of their useful lives or the related lease terms. The provision for amortization of leased properties is included in depreciation and amortization expense. Included in property and equipment are assets held for sale in the amount of $15 million. During fiscal 2000, the Company realized a gain on the sale of property and equipment of $7.8 million. Goodwill $#151; Goodwill, which represents the cost in excess of fair value of net assets acquired, is amortized on the straight-line basis over 40 years. Accumulated goodwill amortization was $40.0 million and $24.1 million at February 3, 2001 and January 29, 2000, respectively. The Company follows SFAS No. 121, "Accounting for Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of," which requires impairment losses to be recorded on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amount. In evaluation of the fair value and future benefits of long-lived assets, the Company performs an analysis of the anticipated undiscounted future net cash flows of the related long-lived assets and reduces their carrying value by the excess, if any, of the results of such calculation. Management believes at this time that carrying value and useful lives continue to be appropriate, after adjusting for the impairment charge recorded in 2000, as disclosed in Note 13. Revenue Recognition $#151; The Company recognizes revenue at the "point of sale." Finance charge revenue earned on customer accounts, serviced by the Company under its private-label credit card program, is recognized in the period in which it is earned. Allowance for sales returns is recorded as a component of net sales in the period in which the related sales are recorded. Advertising $#151; Advertising and promotional costs, which include newspaper, television, radio and other media advertising, are expensed as incurred and were $246 million, $243 million and $220 million for fiscal years 2000, 1999 and 1998, respectively. Income Taxes $#151; In accordance with SFAS No. 109, "Accounting for Income Taxes," deferred income taxes reflect the future tax consequences of differences between the tax bases of assets and liabilities and their financial reporting amounts at year-end. Shipping and Handling $#151; Emerging Issues Task Force ("EITF") Issue 00-10, "Accounting for Shipping and Handling Fees and Costs," requires that all amounts billed to a customer in a sale transaction related to shipping and handling, if any, should be classified as revenue. As required, the Company adopted this EITF in the fourth quarter of fiscal 2000 and has reclassified shipping and handling reimbursements to Other Income for all periods. The Company recorded shipping and handling costs in Advertising, Selling, General and Administrative Expenses for all periods presented. The amount of shipping and handling reimbursements reclassified was $7.4 million, $5.9 million and $5.3 million for fiscal 2000, 1999 and 1998, respectively. Comprehensive Income $#151; In February 1998, the Company adopted the provisions of SFAS No. 130, "Reporting Comprehensive Income," which is required for fiscal years beginning after December 15, 1997. Comprehensive income is equivalent to the Company's net income for fiscal years 2000, 1999 and 1998. Segment Reporting $#151; In February 1998, the Company adopted the provisions of SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." SFAS No. 131 is effective for fiscal years beginning after December 15, 1997, and establishes standards for reporting information about a company's operating segments. It also establishes standards for related disclosures about products and services, geographic areas and major customers. The Company operates in a single operating segment - of operations of retail department stores. Revenues from external customers are derived from merchandise sales and service charges and interest on the Company's private-label credit card. The Company's merchandise sales mix by product category for the last three years was as follows

The Company does not rely on any major customers as a source of revenue.

New Accounting Pronouncements $#151; In June 1998, SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities” was issued. In June 2000, SFAS No. 138, “Accounting for Certain Derivative Instruments and Hedging Activities, an Amendment of FASB Statement No. 133” was issued. SFAS 133 and SFAS 138 address the accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and hedging activities. The Company is required to adopt SFAS 133 and SFAS 138 in the first quarter of 2001. The Company anticipates that the adoption of SFAS 133 and SFAS 138 as of February 4, 2001 will not have a material effect on its financial position or results of operations.

In September 2000, the FASB issued SFAS No. 140, “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.” SFAS No. 140, which replaces SFAS No. 125, “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,” provides accounting and reporting standards for securitizations and other transfers of assets. The Standard is based on the application of a financial components approach that focuses on control, and provides consistent standards for distinguishing transfers of financial assets that are sales from transfers that are secured borrowings. The Standard requires disclosure of information about securitized assets, including principal outstanding of securitized and other managed assets, accounting policies, key assumptions related to the determination of the fair value of retained interests, delinquencies and credit losses. These disclosures are included in Note 15. The accounting requirements of the Standard are effective for transfers and servicing of financial assets and extinguishments of liabilities occurring after March 31, 2001, and must be applied prospectively. Early adoption of the new rules is not allowed. The Company does not expect the application of SFAS No. 140 to be material to its financial position or results of operations.

The Company completed its acquisition (the “Acquisition”) of Mercantile Stores Company, Inc. (“Mercantile”) on August 13, 1998 for a cash purchase price of approximately $3 billion. Mercantile was a conventional department store retailer engaged in the general merchandising business, operating 106 department and home fashion stores under 13 different names in a total of 17 states. The Acquisition was accounted for under the purchase method and, accordingly, Mercantile’s results of operations have been included in the Company’s results of operations since August 13, 1998. The purchase price has been allocated to Mercantile’s assets and liabilities based on their estimated fair values as of that date. Excess cost over fair value of net assets was allocated to goodwill. In connection with the Acquisition, the Company sold and exchanged, respectively, 26 acquired stores and seven acquired stores to other retailers, with the Company receiving nine stores as a result of the exchange agreement. The results of operations of the sold or exchanged stores are included in the accompanying consolidated financial statements from the date of acquisition to the date of sale or exchange.

On a pro forma basis, if the Acquisition and related financing transactions had occurred at the beginning of fiscal 1998, the Company would have realized net sales of $8.9 billion, net income of $111 million, basic earnings per share of $1.04 per share and fully diluted earnings per share of $1.03 per share for the year ended January 30, 1999.

3. Revolving Credit Agreement

At February 3, 2001 and January 29, 2000, there were no commercial paper borrowings outstanding. The average amount of commercial paper outstanding during fiscal 2000 was $14 million, at a weighted average interest rate of 6.63%. The average amount of commercial paper outstanding during fiscal 1999 was $31 million, at a weighted average interest rate of 5.35%.

At February 3, 2001, the Company and a subsidiary, Dillard Investment Co., Inc. (“DIC”), maintained revolving line of credit agreements with various banks aggregating $750 million. The line of credit agreements require that consolidated stockholders’ equity be maintained at no less than $1 billion. These agreements expire on May 9, 2002 and cannot be withdrawn except in the case of defaults by the Company or DIC. The Company pays an annual commitment fee of .10% of the committed amount to the banks. Interest may be fixed for periods from one to six months at the election of the Company or DIC. Interest is payable at the lead bank’s certificate of deposit rate, alternative base rate or Eurodollar rate. There were no funds borrowed under the revolving line of credit agreements during fiscal years 1998 through 2000.

4. Long-term Debt

Maturities of long-term debt over the next five years are $209 million, $110 million, $155 million, $199 million and $103 million, respectively. The Company has guaranteed the borrowings of a 50% owned joint venture. At February 3, 2001, the joint venture has $167 million of borrowings outstanding under its credit facility, which were secured by certain shopping center assets and leases.

Interest paid during fiscal 2000, 1999 and 1998 was approximately $302.5 million, $287.9 million and $149.3 million, respectively. 5.

6. Income Taxes

In connection with the gain on the early extinguishments of debt and the loss on the cumulative effect of an accounting change, the Company realized income tax expense of $15.4 million and income tax benefit of $73.1 million, respectively, in 2000. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The Company's actual federal and state income tax rate (exclusive of the effect of non-deductible goodwill amortization) was reduced from 37% in fiscal 1999 to 36% in fiscal 2000, as a result of lower effective combined income tax rates. The effect of these reduced rates on the Company's deferred income taxes was to reduce the income tax provision by $16 million for fiscal 2000.

7. Guaranteed Preferred Beneficial Interests in the Company's Subordinated Debentures

Guaranteed Preferred Beneficial Interests in the Company’s Subordinated Debentures are comprised of $200 million liquidation amount of 7.5% Capital Securities, due August 1, 2038 (the “Capital Securities”) representing beneficial ownership interest in the assets of Dillard’s Capital Trust I, a wholly owned subsidiary of the Company, and $331.6 million liquidation amount of LIBOR plus 1.56% Preferred Securities, due January 29, 2009 (the “Preferred Securities”) by Horatio Finance V.O.F., a wholly owned subsidiary of the Company.

Holders of the Capital Securities are entitled to receive cumulative cash distributions, payable quarterly, at the annual rate of 7.5% of the liquidation amount of $25 per Capital Security. The subordinated debentures are the sole assets of the Trust and the Capital Securities are subject to mandatory redemption upon repayment of the subordinated debentures. Holders of the Preferred Securities are entitled to receive quarterly dividends at LIBOR plus 1.56%. The Preferred Securities are subject to mandatory redemption upon repayment of the debentures. The Company’s obligations under the debentures and related agreements, taken together, provide a full and unconditional guarantee of payments due on the Capital and Preferred Securities.

8. Benefit Plans

The Company has a retirement plan with a 401(k) salary deferral feature for eligible employees. Under the terms of the plan, employees may contribute up to 5% of gross earnings which will be matched 100% by the Company. The contributions are used to purchase Class A Common Stock of the Company for the account of the employee. The terms of the plan provide a five-year cliff-vesting schedule for the Company contribution to the plan. The costs to the Company for the 401(k) plan were $19 million, $19 million and $16 million for fiscal 2000, 1999 and 1998, respectively.

Prior to its acquisition by the Company, Mercantile maintained formal, qualified and non-qualified, non-contributory, defined benefit pension plans (the “Plans”). In fiscal 1998, the Company froze all benefits accreting to employees covered by the Plans, and applied to the applicable governmental authorities to distribute the benefits owed to each participant, in the form of lump-sum payments or nonparticipating annuity contracts, at the participant’s election. In connection with the Acquisition, the Company recognized as prepaid pension costs all remaining unrecognized plan assets in excess of the actuarial present value of the benefit obligations. During fiscal 1999, the Company distributed all benefits to Plan participants in the form of lump-sum payments or nonparticipating annuity contracts and at March 7, 2000 no benefit obligation was outstanding.

9. Stockholders' Equity

Holders of Class A are empowered as a class to elect one-third of the members of the Board of Directors and the holders of Class B are empowered as a class to elect two-thirds of the members of the Board of Directors. Shares of Class B are convertible at the option of any holder thereof into shares of Class A at the rate of one share of Class B for one share of Class A.

10. Earnings per Share

In accordance with SFAS No. 128, “Earnings Per Share,” basic earnings per share has been computed based upon the weighted average of Class A and Class B common shares outstanding, after deducting preferred dividend requirements. Diluted earnings per share gives effect to outstanding stock options.

Options to purchase 9,465,383, 7,988,849 and 5,448,443 shares of Class A Common Stock at prices ranging from $18.125 to $ 40.22 per share were outstanding in fiscal 2000, 1999 and 1998, respectively, but were not included in the computation of diluted earnings per share because the exercise price of the options exceeds the average market price and would have been antidilutive. 11. Stock Options The Company's 2000 Incentive and Nonqualified Stock Option Plan provides for the granting of options to purchase 8,000,000 shares of Class A Common Stock to certain key employees of the Company. Exercise and vesting terms for options granted under this plan are determined at each grant date. All options were granted at not less than fair market value at dates of grant. At the end of fiscal 2000, 5,846,000 shares were available for grant under the plan and 8,000,000 shares of Class A Common Stock were reserved for issuance under the 2000 stock option plan. The Company's 1998 Incentive and Nonqualified Stock Option Plan provides for the granting of options to purchase 6,000,000 shares of Class A Common Stock to certain key employees of the Company. Exercise and vesting terms for options granted under this plan are determined at each grant date. All options were granted at not less than fair market value at dates of grant. At the end of fiscal 2000, 414,395 shares were available for grant under the plan and 5,835,151 shares of Class A Common Stock were reserved for issuance under the 1998 stock option plan. The Company's 1990 Incentive and Nonqualified Stock Option Plan provides for the granting of options to purchase 12,000,000 shares of Class A Common Stock to certain key employees of the Company. Exercise and vesting terms for options granted under this plan are determined at each grant date. All options were granted at not less than fair market value at dates of grant.

SFAS No. 123, "Accounting for Stock Based Compensation," permits compensation expense to be measured based on the fair value of the equity instrument awarded. In accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," no compensation cost has been recognized in the consolidated statements of operations for the Company's stock option plans. If compensation cost for the Company's stock option plans had been determined in accordance with the fair value method prescribed by SFAS No. 123, the Company's income before extraordinary item and accounting change would have been $89 million, $151 million and $125 million for 2000, 1999 and 1998, respectively. Diluted earnings per share before extraordinary item and accounting change would have been $0.98, $1.43 and $1.16 for 2000, 1999 and 1998, respectively. Basic earnings per share before extraordinary item and accounting change would have been $0.98, $1.43 and $1.16 for 2000, 1999 and 1998, respectively. The fair values generated by the Black-Scholes model may not be indicative of the future benefit, if any, that may be received by the option holder. 12.

Contingent rentals on certain leases are based on a percentage of annual sales in excess of specified amounts. Other contingent rentals are based entirely on a percentage of sales.

Various legal proceedings, in the form of lawsuits and claims which occur in the normal course of business, are pending against the Company and its subsidiaries. In the opinion of management, disposition of these matters is not expected to materially affect the Company’s financial position, cash flows or results of operations.

13. Asset Impairment and Store Closing Charges

During the fourth quarter of 2000, the Company recorded a pre-tax charge of $51 million for asset impairment and store closing costs. The charge includes a write-down to fair value for certain under-performing properties in the amount of $37 million, and exit costs to close four such properties in the amount of $14 million. The Company does not expect to incur significant additional exit costs upon the closing of these properties in fiscal 2001. During fiscal 1999, the Company recorded a pre-tax asset impairment charge of $70 million related to the write-down to fair value of eight under-performing properties, all of which were closed during fiscal 2000.

14. Fair Value Disclosures

The estimated fair values of financial instruments which are presented herein have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required in interpreting market data to develop estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of amounts the Company could realize in a current market exchange.

The fair value of trade accounts receivable is determined by discounting the estimated future cash flows at current market rates, after consideration of credit risks and servicing costs using historical rates. The fair value of the Company’s long-term debt and Guaranteed Preferred Beneficial Interests in the Company’s Subordinated Debentures is based on market prices or dealer quotes (for publicly traded unsecured notes) and on discounted future cash flows using current interest rates for financial instruments with similar characteristics and maturity (for bank notes and mortgage notes).

The fair value of the Company’s cash and cash equivalents and trade accounts receivable approximates their carrying values at February 3, 2001 and January 29, 2000 due to the short-term maturities of these instruments. The fair value of the Company’s long-term debt at February 3, 2001 and January 29, 2000 was $2.30 billion and $2.82 billion, respectively. The carrying value of the Company’s long-term debt at February 3, 2001 and January 29, 2000 was $2.58 billion and $3.00 billion, respectively. The fair value of the Guaranteed Preferred Beneficial Interests in the Company’s Subordinated Debentures at February 3, 2001 and January 29, 2000 was $463 million and $469 million, respectively. The carrying value of the Guaranteed Preferred Beneficial Interests in the Company’s Subordinated Debentures at February 3, 2001 and January 29, 2000 was $532 million.

15. Securitizations of Assets

The Company utilizes credit card securitizations as a part of its overall funding strategy. Under generally accepted accounting principles, if the structure of the securitization meets certain requirements, these transactions are accounted for as sales of receivables. As part of its credit card securitizations, the Company transfers credit card receivable balances to a Master Trust (“Trust”) in exchange for certificates representing undivided interests in such receivables. In January 1999, a Class A certificate with a market value of $300 million was sold to a third party. The Company owns the remaining undivided interest in the trust not represented by the Class A certificate, which is classified in accounts receivable. The undivided interest in the trust represents securities that the Company intends to hold to maturity in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 115, “Accounting for Certain Investments in Debt and Equity Securities.” Due to the short-term revolving nature of the credit card portfolio, the carrying value of the Company’s undivided interest in the trust approximates fair value.

The Trust securitizes balances by issuing certificates representing undivided interests in the Trust’s receivables to outside investors. In each securitization transaction, the Company retains certain subordinated interests that serve as a credit enhancement to outside investors and expose the Company’s Trust assets to possible credit losses on receivables sold to outside investors. The investors and the Trust have no recourse against the Company beyond Trust assets. In order to maintain the committed level of securitized assets, the Company reinvests cash collections on securitized accounts in additional balances.

Due to the qualified status of the Trust, the issuance of certificates to outside investors is considered a sale for which the Company recognizes a gain and an asset representing the Company’s rights to future cash flows arising after the investors in the Trust have received the return for which they contracted. The Company also receives annual servicing fees as compensation for servicing the outstanding balances. In connection with its securitization transactions, the Company recognized other income of $5 million during fiscal 2000.

The Company measures its net securitization gains using the present value of estimated future cash flows. The valuations technique requires the use of key economic assumptions about repayment rates, credit losses and interest rates. The following table shows the key economic assumptions used in measuring the securitization gains.

These sensitivities are hypothetical and are presented for illustrative purposes only. Changes in fair value based on a change in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. The changes in assumptions presented in the above table were calculated without changing any other assumption; in reality, changes in one assumption may result in changes in another, which may magnify or counteract the sensitivities.

16. Quarterly Results of Operations (unaudited)

During the fourth quarter of 2000, the Company changed its method of accounting for inventories under the retail inventory method. The cumulative effect of the accounting change as of January 30, 2000 was to decrease net income for fiscal year 2000 by $130 million, net of tax, or $1.42 per share.

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

None.

**ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISRTANT.**

A. Directors of the Registrant

Information regarding directors of the Registrant is incorporated herein by reference to the

information on pages 5 through 7 under the heading "Nominees for Election as Directors" and pages 12

and 13 under the heading "Section 16(a) Beneficial Ownership Reporting Compliance" in the Proxy

Statement.

B. Executive Officers of the Registrant

Information regarding executive officers of the Registrant is incorporated herein by reference to

Item 1 of this report under the heading "Executive Officers of the Registrant". Reference

additionally is made to the information under the heading "Section 16(a) Beneficial Ownership

Reporting Compliance" on pages 12 and 13 in the Proxy Statement, which information is incorporated

herein by reference.

**ITEM 11. EXECUTIVE COMPENSATION.**

Information regarding executive compensation and compensation of directors is incorporated herein by

reference to the information beginning on page 8 under the heading "Compensation of Directors and

Executive Officers" and concluding on page 10 under the heading "Compensation of Directors" in the Proxy

Statement.

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

Information regarding security ownership of certain beneficial owners and management is incorporated

herein by reference to the information on page 4 under the heading "Principal Holders of Voting

Securities" and page 5 under the heading "Nominees for Election as Directors" and continuing through

footnote 13 on page 7 in the Proxy Statement.

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

Information regarding certain relationships and related transactions is incorporated herein by reference

to the information on page 12 under the heading "Certain Relationships and Transactions" in the Proxy

Statement.