CONNS INC
Form 10-Q
November 30, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended	Commission File Number
October 31, 2006	000-50421

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

A Delaware Corporation	06-1672840
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

3295 College Street
Beaumont, Texas 77701
(409) 832-1696
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

NONE
(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check One):
Large accelerated filer [ ] Accelerated filer [x] Non-accelerated filer [ ]

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of November 27, 2006:

Class	Outstanding
Common stock, $.01 par value per share	23,735,622

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.....

Consolidated Balance Sheets as of January 31, 2006 and October 31, 2006.....

Consolidated Statements of Operations for the three and nine months ended October 31, 2005 and 2006.....

Consolidated Statement of Stockholders' Equity for the nine months ended October 31, 2006.....

Consolidated Statements of Cash Flows for the nine months ended October 31, 2005 and 2006.....

Notes to Consolidated Financial Statements.....

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.....

Item 3. Quantitative and Qualitative Disclosures About Market Risk.....

Item 4. Controls and Procedures.....

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.....

Item 1A. Risk Factors.....

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.....

Item 5. Other Information.....

Item 6. Exhibits.....

SIGNATURE .....

Part I. FINANCIAL INFORMATION
Item 1. Financial Statements

Conn's, Inc.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)
(As Adjusted, see Note 1, and As Restated, see Note 8)

Assets

Current assets	
Cash and cash equivalents	
Accounts receivable, net	
Interests in securitized assets	
Inventories	
Deferred income taxes	
Prepaid expenses and other assets	
Total current assets	
Non-current deferred income tax asset	
Property and equipment	
Land	
Buildings	
Equipment and fixtures	
Transportation equipment	
Leasehold improvements	
Subtotal	
Less accumulated depreciation	
Total property and equipment, net	
Goodwill, net	
Debt issuance costs and other assets, net	
Total assets	

Liabilities and Stockholders' Equity

Current liabilities	
Current portion of long-term debt	
Accounts payable	
Accrued compensation and related expenses	
Accrued expenses	
Income taxes payable	
Deferred income taxes	
Deferred revenues and allowances	
Total current liabilities	
Long-term debt	
Deferred gain on sale of property	
Stockholders' equity	
Preferred stock ($0.01 par value, 1,000,000 shares authorized; none issued or outstanding)	
Common stock ($0.01 par value, 40,000,000 shares authorized; 23,571,564 and 23,735,122 shares issued and outstanding at January 31, 2006 and October 31, 2006, respectively)	
Additional paid-in capital	
Accumulated other comprehensive income	
Retained earnings	

Treasury stock, at cost, 0 and 33,800 shares, respectively	
Total stockholders' equity	
Total liabilities and stockholders' equity	

See notes to consolidated financial statements.

Conn's, Inc.
CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)
(in thousands, except earnings per share)
(As Adjusted, See Note 1 and As Restated, See Note 8)

	Three Months Ende October 31,	
	2005	2006
Revenues		
Product sales	$140,405	$139,59
Service maintenance agreement commissions, net	7,506	6,84
Service revenues	5,157	5,95
Total net sales	153,068	152,39
Finance charges and other	19,521	21,30
Total revenues	172,589	173,69
Cost and expenses		
Cost of goods sold, including warehousing and occupancy costs	110,024	110,62
Cost of parts sold, including warehousing and occupancy costs	1,334	1,83
Selling, general and administrative expense	47,152	49,70
Provision for bad debts	331	52
Total cost and expenses	158,841	162,68
Operating income	13,748	11,00
Interest (income) expense, net	74	(14
Other (income) expense, net	(27)	(1
Income before income taxes	13,701	11,16
Provision for income taxes		
Current	5,623	4,44
Deferred	(777)	(43

Total provision for income taxes	4,846	4,01
Net income	$ 8,855	$ 7,15
Earnings per share		
Basic	$ 0.38	$ 0.3
Diluted	$ 0.36	$ 0.3
Average common shares outstanding		
Basic	23,458	23,69
Diluted	24,265	24,16

See notes to consolidated financial statements.

Conn's, Inc.
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
Nine Months Ended October 31, 2006
(unaudited)
(in thousands except descriptive shares)
(As Adjusted, See Note 1 and As Restated, See Note 8)

	Common Stock		Accum. Other Compre- hensive Income	Additional Paid-in Capital	Retai Earni
	Shares	Amount			
Balance January 31, 2006	23,572	$236	$10,492	$89,027	$156,
Exercise of options to acquire 155,328 shares of common stock	155	1		1,510	
Issuance of 8,230 shares of common stock under Employee Stock Purchase Plan	8			184	
Stock-based compensation				1,204	
Purchase of 33,800 shares of treasury stock					
Tax benefit from options exercised				196	
Net income					27,
Adjustment of fair value of securitized assets (including tax benefit of $2,276), net of reclassification					

adjustments of $6,909 (net of tax of $3,886)			(4,368)		
Total comprehensive income					
Balance October 31, 2006	23,735	$237	$ 6,124	$92,121	$183,

See notes to consolidated financial statements.

Conn's, Inc.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited) (in thousands)
(As Adjusted, See Note 1 and As Restated, See Note 8)

Cash flows from operating activities
Net income
Adjustments to reconcile net income to net cash provided by operating activities:
Depreciation
Amortization
Provision for bad debts
Stock-based compensation
Excess tax benefits from stock-based compensation
Discounts on promotional credit
Accretion from interests in securitized assets
Provision for deferred income taxes
Loss (Gain) from sale of property and equipment
Loss from derivatives
Changes in operating assets and liabilities:
Accounts receivable
Inventory
Prepaid expenses and other assets
Accounts payable
Accrued expenses
Income taxes payable
Deferred revenue and allowances
Net cash provided by operating activities
Cash flows from investing activities
Purchase of property and equipment
Proceeds from sales of property
Net cash used in investing activities
Cash flows from financing activities
Proceeds from stock issued under employee benefit plans

Purchase of treasury stock	
Excess tax benefits from stock-based compensation	
Borrowings under lines of credit	
Payments on lines of credit	
Increase in debt issuance costs	
Borrowings under promissory notes	
Payment of promissory notes	
Net cash provided by (used in) financing activities	
Net change in cash	
Cash and cash equivalents	
Beginning of the year	
End of period	

See notes to consolidated financial statements.

Conn's , Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)
October 31, 2006

1. Summary of Significant Accounting Policies

Basis of Presentation. The accompanying unaudited, condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. The accompanying financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair statement of the results for the interim periods presented. All such adjustments are of a normal recurring nature. Operating results for the three and nine month periods ended October 31, 2006 are not necessarily indicative of the results that may be expected for the year ending January 31, 2007. The financial statements should be read in conjunction with the Company's (as defined below) audited consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K/A filed on September 15, 2006.

The Company's balance sheet at January 31, 2006, as adjusted for Statement of Financial Accounting Standards No. 123R, has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial presentation. Please see the Company's Form 10-K/A for the fiscal year ended January 31, 2006 for a complete presentation of the audited financial statements at that date, together with all required footnotes, and for a complete presentation and explanation of the components and presentations of the financial statements.

Principles of Consolidation. The consolidated financial statements include the accounts of Conn's, Inc. and its subsidiaries, limited liability companies and limited partnerships, all of which are wholly-owned (the "Company"). All material intercompany transactions and balances have been eliminated in

consolidation.

The Company enters into securitization transactions to sell its retail installment and revolving customer receivables. These securitization transactions are accounted for as sales in accordance with Statement of Financial Accounting Standards ("SFAS") No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities because the Company has relinquished control of the receivables. Additionally, the Company has transferred such receivables to a qualifying special purpose entity ("QSPE"). Accordingly, neither the transferred receivables nor the accounts of the QSPE are included in the consolidated financial statements of the Company. The Company's retained interest in the transferred receivables is valued on a revolving pool basis.

Use of Estimates. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Earnings Per Share. In accordance with SFAS No. 128, Earnings per Share, the Company calculates basic earnings per share by dividing net income by the weighted average number of common shares outstanding. Diluted earnings per share include the dilutive effects of any stock options granted calculated under the treasury-stock method. The following table sets forth the shares outstanding for the earnings per share calculations:

	Three Months Ended October 31,	
	2005	2006
Common stock outstanding, beginning of period	23,388,235	23,697,318
Weighted average common stock issued in stock option exercises	68,646	15,100
Weighted average common stock issued to employee stock purchase plan	866	1,184
Weighted average treasury stock purchased	-	(15,185)
Shares used in computing basic earnings per share	23,457,747	23,698,417
Dilutive effect of stock options, net of assumed repurchase of treasury stock	807,565	466,741
Shares used in computing diluted earnings per share	24,265,312	24,165,158

Goodwill. Goodwill represents the excess of purchase price over the fair market value of net assets acquired. The Company assesses the potential future impairment of goodwill on an annual basis, or at any other time when impairment

indicators exist. The Company concluded at January 31, 2006 and October 31, 2006 that no impairment of goodwill existed.

Stock-Based Compensation. On February 1, 2006, the Company adopted SFAS No. 123R, Stock-Based Payment, using the modified retrospective application transition. Under the modified retrospective application transition, all prior period financial statements have been adjusted to give effect to the fair-value-based method of accounting for stock-based compensation. The adoption of this statement impacted the financial statements presented as follows:

- For the three months ended October 31, 2005 and 2006, Income before income taxes was reduced by $0.2 million and $0.4 million, respectively. For the nine months ended October 31, 2005 and 2006, Income before income taxes was reduced by $0.8 million and $1.2 million, respectively.

- For the three months ended October 31, 2005 and 2006, Net income was reduced by $0.2 million and $0.3 million, respectively. For the nine months ended October 31, 2005 and 2006, Net income was reduced by $0.6 million and $1.0 million, respectively.

- For the three months ended October 31, 2005 and 2006, Basic earnings per share was reduced by $.01 and $.01, respectively. For the nine months ended October 31, 2005 and 2006, Basic earnings per share was reduced by $.03 and $.04, respectively.

- For the three months ended October 31, 2005 and 2006, Diluted earnings per share was reduced by $.01 and $.01, respectively. For the nine months ended October 31, 2005 and 2006, Diluted earnings per share was reduced by $.03 and $.04, respectively.

- For the nine months ended October 31, 2005 and 2006, Cash flows from operating activities were reduced by, and Cash flows from investing activities were increased by, $0.0 and $0.2 million, respectively.

- As of January 31, 2006, the Current deferred income tax asset increased $0.3 million, Additional paid-in capital increased $2.0 million and Retained earnings decreased $1.7 million.

For post-IPO stock option grants, the Company has used the Black-Scholes model to determine fair value. Stock-based compensation expense is recorded, net of estimated forfeitures, on a straight-line basis over the vesting period of the applicable grant. Prior to the IPO, the value of the options issued was estimated using the minimum valuation option-pricing model. Since the minimum valuation option-pricing model does not qualify as a fair value pricing model under FAS 123R, the Company follows the intrinsic value method of accounting for stock-based compensation to employees for these grants, as prescribed by Accounting Principles Board ("APB") Opinion No. 25, Accounting for Stock Issued

to Employees, and related interpretations. If compensation expense for the Company's stock options granted prior to the IPO had been recognized using the fair value method of accounting under SFAS No. 123, net income available for common stockholders for the three months ended October 31, 2005 and 2006 would have decreased by 0.8% and 0.2%, respectively. Net income available for common stockholders for the nine months ended October 31, 2005 and 2006 would have decreased by 1.0% and 0.4%, respectively. The following table presents the

impact to earnings per share as if the Company had adopted the fair value recognition provisions of SFAS No. 123 (dollars in thousands except per share data):

	Three Months October 2005	
Net income available for common stockholders as reported	$8,855	$7
Add: Stock-based compensation recorded, net of tax	199	
Less: Stock-based compensation, net of tax for all awards	(271)	
Pro forma net income	$8,783	$7
Earnings per share-as reported:		
Basic	$ 0.38	$
Diluted	$ 0.36	$
Pro forma earnings per share:		
Basic	$ 0.37	$
Diluted	$ 0.36	$

As of October 31, 2006, the total compensation cost related to non-vested awards not yet recognized totaled $4.3 million and is expected to be recognized over a weighted average period of 3.3 years.

Application of APB 21 to Promotional Credit Programs that Exceed One Year in Duration: The Company offers promotional credit payment plans, on certain products, that extend beyond one year. In accordance with APB 21, Interest on Receivables and Payables, such sales are discounted to their fair value resulting in a reduction in sales and receivables and the amortization of the discount amount over the term of the deferred interest payment plan. The difference between the gross sale and the discounted amount is reflected as a reduction of Product sales in the consolidated statements of operations and the amount of the discount being amortized in the current period is recorded in Finance charges and other. For the three months ended October 31, 2005 and 2006, Product sales were reduced by $0.7 million and $1.7 million, respectively, and Finance charges and other was increased by $0.7 million and $0.8 million, respectively, to effect the adjustment to fair value and to reflect the appropriate amortization of the discount. For the nine months ended October 31, 2005 and 2006, Product sales were reduced by $2.3 million and $3.3 million, respectively, and Finance charges and other was increased by $1.7 million and $2.3 million, respectively, to effect the adjustment to fair value and to reflect the appropriate amortization of the discount.

Texas Tax Law Changes. On May 18, 2006, the Governor of Texas signed a tax bill that modified the existing franchise tax, with the most significant change being the replacement of the existing base with a tax based on margin. Taxable margin is generally defined as total federal tax revenues minus the greater of (a) cost of goods sold or (b) compensation. The tax rate to be paid by retailers and wholesalers is 0.5% on taxable margin. This will result in an increase in taxes paid by the Company, as franchise taxes paid have totaled less than $50,000 per year for the last several years.

The tax changes impacted earnings beginning in the quarter ended July 31,

2006. For the quarter and nine months ended October 31, 2006, the Company accrued, net of federal tax benefit, approximately $173,000 and $290,000, respectively, in additional tax liability and had initially recorded approximately $29,000 in deferred tax assets as a result of the new margin tax.

Recent Accounting Pronouncements. In October 2005, FASB Staff Position (FSP) No. 13-1, Accounting for Rental Costs Incurred during a Construction Period, was issued. This FSP addresses the accounting for rental costs associated with operating leases that are incurred during a construction period. It requires that those costs be recognized as rental expense and included in income from continuing operations. The guidance in this FSP is to be applied to the first reporting period beginning after December 15, 2005 and states that a lessee shall cease capitalizing rental costs as of the effective date of the FSP for operating lease arrangements entered into prior to the effective date of the FSP. The Company implemented the guidance in this FSP as of February 1, 2006, and it did not have a material impact on its financial condition or results of operations.

In February 2006, SFAS No. 155, Accounting for Certain Hybrid Financial Instruments, was issued. This statement is an amendment of SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities-a replacement of FASB Statement No. 125. This statement permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that would otherwise require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133, establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives and amends SFAS No. 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. This statement is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Company is currently analyzing the impact this statement will have on its financial condition and results of operations.

In February 2006, the FASB Emerging Issues Task Force issued EITF No. 06-3, How Sales Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross Versus Net Presentation). The Task Force reached a consensus that a company should disclose its accounting policy (i.e., gross or net presentation) regarding presentation of taxes within the scope of this Issue. If taxes included in gross revenues are significant, a company should disclose the amount of such taxes for each period for which an income statement is presented. The consensus is effective for the first annual or interim reporting period beginning after December 15, 2006. The disclosures are required for annual and interim financial statements for each period for which an income statement is presented. The Company has evaluated the EITF and will disclose its accounting policy regarding the presentation of sales taxes beginning with the first quarter of fiscal 2008.

In July 2006, FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109, Accounting for Income Taxes, was issued. This interpretation clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. The interpretation is effective for fiscal years beginning after December 15, 2006. The Company is currently analyzing the impact this statement will have on its financial condition and results of operations.

In September 2006, SFAS No. 157, Fair Value Measurements, was issued. This statement clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently analyzing the impact this statement will have on its financial condition and results of operations.

In September 2006, Staff Accounting Bulletin (SAB) No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements, was issued. This bulletin addresses how the effects of prior year uncorrected errors must be considered in quantifying misstatements in the current year financial statements. This bulletin is effective for fiscal years ending after November 15, 2006.

Reclassifications. Certain reclassifications have been made in the prior year's financial statements to conform to the current year's presentation. Specifically, Other (income) expense, which consists of (gain) loss on sales of property and equipment, is now separately detailed. Previously these amounts were included in Selling, general and administrative expense. Additionally, the impact of the cancellation of insurance policies on charged-off receivables, which were previously included in the Provision for bad debts on the consolidated statements of operations, are now reported as a reduction of Insurance commissions, which is included in Finance charges and other.

2. Supplemental Disclosure of Revenue and Comprehensive Income

The following is a summary of the classification of the amounts included as Finance charges and other for the three and nine months ended October 31, 2005 and 2006 (in thousands):

	Three Months October 31	
	2005	
Securitization income (1)	$15,146	$16
Income from receivables not sold	319	
Insurance commissions	3,643	4
Other	413	

Finance charges and other	$19,521	$21

(1) Due to the expectation of higher credit losses during the last six months of the current fiscal year, resulting primarily from disruption to our credit operations as a result of Hurricane Rita, a $1.5 million impairment charge was recorded in Securitization income during the three months ended July 31, 2006. The impairment charge was based on an estimated average credit charge-off rate of 3.6% over the six month period ending January 31, 2007. The increase in credit losses for three month period was in-line with our expectations at the time we recorded the impairment charge. The charge-off rate used in the valuation of the interest in securitized assets is expected to return to the level of the historical 3.0% charge-off rate assumption at the beginning of the next fiscal year.

The components of total comprehensive income for the three and nine months ended October 31, 2005 and 2006 are presented in the table below (in thousands):

	Three Months October 3	
	2005	
Net income	$8,855	$ 7
Unrealized gain on derivative instruments	-	
Taxes on unrealized gain on derivatives	-	
Adjustment of fair value of securitized assets (1)	891	(6
Taxes on adjustment of fair value	(302)	2
Total comprehensive income	$9,444	$ 2

(1) As a result of the completion of a new bond issuance by the QSPE, the discount recorded on the Company's investment was increased to reflect the impact of the longer term to maturity.

3. Supplemental Disclosure Regarding Managed Receivables

The following tables present quantitative information about the receivables portfolios managed by the Company (in thousands):

	Total Princ Amount of Receivable	
	January	Octo

	31, 2006	3 20
Primary portfolio:		
Installment	$380,603	$362
Revolving	41,046	51
Subtotal	421,649	413
Secondary portfolio:		
Installment	98,072	122
Total receivables managed	519,721	535
Less receivables sold	509,681	525
Receivables not sold	10,040	9
Non-customer receivables	13,502	20
Total accounts receivable, net	$ 23,542	$ 30

(1) Amounts are based on end of period balances. The principal amount 60 days or more past due relative to total receivables managed is not necessarily indicative of relative balances expected at other times during the year due to seasonal fluctuations in delinquency.

	Average Bal	
	Three Mon Ended October	
	2005	
Primary portfolio:		
Installment	$357,015	$3
Revolving	37,521	
Subtotal	394,536	4
Secondary portfolio:		
Installment	84,994	1
Total receivables managed	479,530	5
Less receivables sold	469,586	5
Receivables not sold	$ 9,944	$

(1) Amounts represent total credit charge-offs, net of recoveries, on total receivables. The increased level of credit losses is primarily a result of the impact on our credit operations of Hurricane Rita that hit the Gulf Coast during September 2005.

Conn's, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

	Average Bala	
	Nine Mont Ended October 3	
	2005	2
Primary portfolio:		
Installment	$344,348	$36
Revolving	33,748	4
Subtotal	378,096	41
Secondary portfolio:		
Installment	80,060	11
Total receivables managed	458,156	52
Less receivables sold	448,513	51
Receivables not sold	$ 9,643	$ 1

(1) Amounts represent total credit charge-offs, net of recoveries, on total receivables. The increased level of credit losses is primarily a result of the impact on our credit operations of Hurricane Rita that hit the Gulf Coast during September 2005.

4. Fair Value of Derivatives

The Company held interest rate swaps and collars with notional amounts totaling $20.0 million, which expired on April 15, 2005, and were held for the purpose of hedging against variable interest rate risk, primarily related to cash flows from the Company's interest-only strip as well as variable rate debt.

In fiscal 2004, hedge accounting was discontinued for the $20.0 million of swaps. In accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, at the time hedge accounting was discontinued, the Company began to recognize changes in fair value of the swaps as a reduction to interest expense and to amortize the amount of accumulated other comprehensive loss related to those derivatives as interest expense over the period that the forecasted transactions affected the consolidated statements of operations. As the swaps expired on April 15, 2005, there was no financial statement impact during the three months ended October 31, 2005 and 2006. During the nine months ended October 31, 2005 and 2006, the Company reclassified $246,000 and $0, respectively, of losses previously recorded in accumulated other comprehensive income into the consolidated statements of operations and recorded $177,000 and $0, respectively, of interest reductions in the consolidated statements of operations because of the change in fair value of the swaps.

5. Debt and Letters of Credit

At October 31, 2006, the Company had $48.1 million of its $50 million revolving credit facility available for borrowings. The amounts utilized under the revolving credit facility reflected $1.9 million related to letters of credit issued. Additionally, there were no amounts outstanding under a short-term revolving bank agreement that provides up to $8.0 million of availability on an unsecured basis. This unsecured facility matures in June 2007 and has a floating rate of interest, based on Prime, which equaled 7.75% at October 31, 2006.

Effective August 28, 2006, the Company entered into an amendment of its $50 million revolving credit facility with its existing lenders. The amendment increases the Company's restricted payment capacity, which includes payments for repurchases of capital stock, from $25 million to $50 million. There were no other modifications of the Credit Agreement.

The Company utilizes unsecured letters of credit to secure a portion of the QSPE's asset-backed securitization program, deductibles under the Company's property and casualty insurance programs and international product purchases. At October 31, 2006, the Company had outstanding unsecured letters of credit of $23.9 million. These letters of credit were issued under the three following facilities:

- The Company has a $5.0 million sublimit provided under its revolving line of credit for stand-by and import letters of credit. At October 31, 2006, $1.9 million of letters of credit were outstanding and callable at the option of the Company's property and casualty insurance carrier if the Company does not honor its requirement to fund deductible amounts as billed under its insurance program.

- The Company has arranged for a $20.0 million stand-by letter of credit to provide assurance to the trustee of the asset-backed securitization program that funds collected by the Company, as the servicer, would be remitted as required under the base indenture and other related documents. The letter of credit has a term of one year and expires in August 2007.

- The Company obtained a $10.0 million commitment for trade letters of credit to secure product purchases under an international arrangement. At October 31, 2006, there was $1.9 million outstanding under this commitment. The letter of credit commitment has a term of one year and expires in May 2007. No letter of credit issued under this commitment can have an expiration date more than 180 days after the commitment expiration date.

The maximum potential amount of future payments under these letter of credit facilities is considered to be the aggregate face amount of each letter of credit commitment, which total $35.0 million as of October 31, 2006.

6. Stock-Based Compensation

The Company originally approved an Incentive Stock Option Plan that provides for a pool of up to 3.5 million options to purchase shares of the Company's common stock. Such options are to be granted to various officers and employees at prices equal to the market value on the date of the grant. The options vest over three or five year periods (depending on the grant) and expire ten years after the date of grant. As part of the completion of the IPO, the Company

amended the Incentive Stock Option Plan to provide for a total available pool of 2,559,767 options, adopted a Non-Employee Director Stock Option Plan that included 300,000 options, and adopted an Employee Stock Purchase Plan that reserved up to 1,267,085 shares of the Company's common stock to be issued. At the Company's annual meeting on May 31, 2006, amendments to the stock option plans were approved, which increased the shares available under the Incentive Stock Option Plan to 3,859,767 and increased the shares available under the Non-Employee Director Stock Option Plan to 600,000. On November 24, 2003, the Company issued six non-employee directors 240,000 total options to acquire the Company's stock at $14.00 per share. On June 3, 2004, the Company issued 40,000 options to acquire the Company's stock at $17.34 per share to a seventh non-employee director. At October 31, 2006, the Company had 320,000 options available for grant under the Non-Employee Director Stock Option Plan.

The Employee Stock Purchase Plan is available to a majority of the employees of the Company and its subsidiaries, subject to minimum employment conditions and maximum compensation limitations. At the end of each calendar quarter, employee contributions are used to acquire shares of common stock at 85% of the lower of the fair market value of the common stock on the first or last day of the calendar quarter. During the nine month periods ended October 31, 2005 and 2006, the Company issued 8,306 and 8,230 shares of common stock, respectively, to employees participating in the plan, leaving 1,239,695 shares remaining reserved for future issuance under the plan as of October 31, 2006.

A summary of the status of the Company's Incentive Stock Option Plan and the activity during the nine months ended October 31, 2005 and 2006 is presented below (shares in thousands):

	Nine Month	
	2005	
	Shares	Weig Aver Exer Pri
Outstanding, beginning of period	1,666	$ 11
Granted	-	$
Exercised	(220)	$ (8
Forfeited	(79)	$(14
Outstanding, end of period	1,367	$ 11
Options exercisable at end of period	660	
Options available for grant	758	
Intrinsic value of options exercised during the period	$3.1 million	

Range of Exercise Prices	Options Outstanding: Shares Outstanding October 31, 2006	Weighted Average Remaining Contractual Life in Years	Weight Averag Exerci Pric
$8.21-$10.83	583	4.6	$ 8.5
$14.00 -$16.49	281	7.2	$14.2
$17.73	272	8.1	$17.7
$33.88	315	9.1	$33.8
Total	1,451	6.7	$16.8

Aggregate intrinsic value of exercisable options at October 31, 2006 $10.0 million

7. Contingencies

Legal Proceedings. The Company is involved in routine litigation incidental to its business from time to time. Currently, the Company does not expect the outcome of any of this routine litigation to have a material affect on its financial condition or results of operations. However, the results of these proceedings cannot be predicted with certainty, and changes in facts and circumstances could impact the Company's estimate of reserves for litigation.

Service Maintenance Agreement Obligations. The Company sells service maintenance agreements under which it is the obligor for payment of qualifying claims. The Company is responsible for administering the program, including setting the pricing of the agreements sold and paying the claims. The typical term for these agreements is between 12 and 36 months. The pricing is set based on historical claims experience and expectations about future claims. While the Company is unable to estimate maximum potential claim exposure, it has a history of overall profitability upon the ultimate resolution of agreements sold. The revenues related to the agreements sold are deferred at the time of sale and recorded in revenues in the statement of operations over the life of the agreements. The revenues deferred related to these agreements totaled $3.6 million and $3.9 million, respectively, as of January 31, 2006 and October 31, 2006, and are included on the face of the balance sheet in Deferred revenues and allowances.

8. Restatement of Financial Statements

The Company restated its consolidated financial statements for the quarter and nine-months ended October 31, 2005 to correct for errors in recording

interests in securitized assets, securitization income and related income tax impacts that were incorrectly accounted for under U.S. generally accepted accounting principles, specifically covered by Statement of Financial Accounting Standards ("SFAS") No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities and Emerging Issues Task Force ("EITF") No. 99-20, Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interest in Securitized Financial Assets.

The following table sets forth the effects of the adjustments on Net Income for the quarter and nine-months ended October 31, 2005.

Increase (Decrease) in Net Income
(Dollars in thousands)

	Quarter ended October 31, 2005	Nine Months ended October 31, 2005
As Previously Reported net income	$8,932	$27,611
Securitization income	(118)	1,034
Provision for bad debts	-	53
Income tax provision	41	(382)
Total adjustment	(77)	705
Restated net income	$8,855	$28,316
Percent change	-0.9%	2.6%

Conn's, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

The following tables set forth the effects of the restatement adjustments on affected line items within our previously reported Consolidated Statement of Operations for the quarter and nine-months ended October 31, 2005, and Consolidated Statement of Cash Flows for the nine-months ended October 31, 2005.

Conn's, Inc.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except share data)

	Quarter ended October 31, 2005	
	As Previously Reported	Restated
Finance charges and other	$ 20,237	$ 19,521
Total revenues	173,305	172,589
Provision for bad debts	929	331

Total cost and expenses	159,412	158,841
Operating income	13,893	13,748
Income before income taxes	13,819	13,701
Total provision for income taxes	4,887	4,846
Net Income	8,932	8,855
Earnings per share		
Basic	$ 0.38	$ 0.38
Diluted	$ 0.37	$ 0.36

Conn's, Inc.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

Cash flows from operating activities	
Net income	
Adjustments to reconcile net income to	
net cash provided by operating activities:	
Provision for bad debts	
Accretion from interests in securitized assets	
Provision for deferred income taxes	
Change in operating assets and liabilities:	
Accounts receivable	

Conn's, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

This report contains forward-looking statements. We sometimes use words such as "believe," "may," "will," "estimate," "continue," "anticipate," "intend," "expect," "project" and similar expressions, as they relate to us, our management and our industry, to identify forward-looking statements. Forward-looking statements relate to our expectations, beliefs, plans, strategies, prospects, future performance, anticipated trends and other future events. We have based our forward-looking statements largely on our current expectations and projections about future events and financial trends affecting our business. Actual results may differ materially. Some of the risks, uncertainties and assumptions about us that may cause actual results to differ from these forward-looking statements include, but are not limited to:

- the success of our growth strategy and plans regarding opening new stores and entering adjacent and new markets, including our plans to continue expanding into the Dallas/Fort Worth Metroplex, and South Texas;

- our intention to update or expand existing stores;

- our ability to obtain capital for required capital expenditures and costs related to the opening of new stores or to update or expand existing stores;

- our cash flows from operations, borrowings from our revolving line of credit and proceeds from securitizations to fund our operations, debt repayment and expansion;

- the ability of the QSPE to obtain additional funding for the purpose of purchasing our receivables;

- the effect of rising interest rates that could increase our cost of borrowing or reduce securitization income;

- the potential for deterioration in the delinquency status of the sold or owned credit portfolios or higher than historical charge-offs in the portfolios could adversely impact earnings;

- the potential for greater than expected losses in the sold or owned credit portfolios due to the impact of Hurricane Rita on our credit operations;

- the long-term effect of the change in bankruptcy laws could effect charge-offs in the credit portfolio which could adversely impact earnings;

- technological and market developments, growth trends and projected sales in the home appliance and consumer electronics industry, including, with respect to digital products, DVD players, HDTV, digital audio, home networking devices and other new products, and our ability to capitalize on such growth;

- the potential for price erosion or lower unit sales that could result in declines in revenues;

- higher oil and gas prices could adversely affect our customers' shopping decisions and patterns, as well as the cost of our delivery and service operations and our cost of products, if vendors pass on their additional fuel costs through increased pricing for products;

- the ability to attract and retain qualified personnel;

- both short-term and long-term impact of adverse weather conditions (e.g. hurricanes) that could result in volatility in our revenues and increased expenses and casualty losses;

- changes in laws and regulations and/or interest, premium and commission rates allowed by regulators on our credit, credit insurance and service maintenance agreements as allowed by those laws and regulations;

- our relationships with key suppliers;

- the adequacy of our distribution and information systems and management experience to support our expansion plans;
- the accuracy of our expectations regarding competition and our competitive advantages;
- the potential for market share erosion that could result in reduced revenues;
- the accuracy of our expectations regarding the similarity or dissimilarity of our existing markets as compared to new markets we enter; and
- the outcome of litigation affecting our business.

Additional important factors that could cause our actual results to differ materially from our expectations are discussed under "Risk Factors" in our Form 10-K/A filed with the Securities Exchange Commission on September 15, 2006. In light of these risks, uncertainties and assumptions, the forward-looking events and circumstances discussed in this report might not happen.

The forward-looking statements in this report reflect our views and assumptions only as of the date of this report. We undertake no obligation to update publicly or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

All forward-looking statements attributable to us, or to persons acting on our behalf, are expressly qualified in their entirety by these cautionary statements.

General

We intend for the following discussion and analysis to provide you with a better understanding of our financial condition and performance in the indicated periods, including an analysis of those key factors that contributed to our financial condition and performance and that are, or are expected to be, the key "drivers" of our business.

On September 8, 2006, we concluded that our consolidated financial statements for the years ended January 31, 2006, 2005 and 2004 as well as the selected financial data for the years ended January 31, 2006, 2005, 2004, 2003, and July 31, 2001, the six months ended January 31, 2002 and the twelve months ended January 31, 2002, and for the quarters ended April 30, 2006 and 2005 should be restated to correct for errors in recording interests in securitized assets, securitization income and related income tax impacts that were incorrectly accounted for under U.S. generally accepted accounting principles, specifically covered by Statement of Financial Accounting Standards ("SFAS") No. 140, Accounting for transfers and Servicing of Financial Assets and Extinguishment of Liabilities and Emerging Issues Task Force ("EITF") No. 99-20, Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interest in Securitized Financial Assets. The following discussion has been updated, as appropriate, to reflect the changes to our financial statements. See Note 8 to the financial statements for discussion of the impacts on the financial statements.

On February 1, 2006, we were required to adopt Statement of Financial Accounting Standard No. 123R, Stock-Based Compensation. We elected to use the modified retrospective application transition, which results in the retrospective adjustment of all prior period financial statements using the fair-value-based method of accounting for stock-based compensation. As applicable, all amounts disclosed in the financial statements and in

Management's Discussion and Analysis of Financial Condition and Results of Operations have been adjusted accordingly. See Note 1 to the financial statements for discussion of the impacts on the financial statements.

We are a specialty retailer that sells major home appliances, including refrigerators, freezers, washers, dryers and ranges, a variety of consumer electronics, including projection, plasma, DLP and LCD televisions, camcorders, DVD players, portable audio and home theater products, lawn and garden products, mattresses and furniture. We also sell home office equipment, including computers and computer accessories and continue to introduce additional product categories for the consumer and home to help increase same store sales and to respond to our customers' product needs. We require all our sales associates to be knowledgeable of all of our products, but to specialize in certain specific product categories.

We currently operate 60 retail locations in Texas and Louisiana, and have several other stores under development.

Unlike many of our competitors, we provide flexible in-house credit options for our customers. In the last three years, we financed, on average, approximately 57% of our retail sales through our internal credit programs. We finance a large portion of our customer receivables through an asset-backed securitization facility, and we derive servicing fee income and interest income from these assets. As part of our asset-backed securitization facility, we have created a qualifying special purpose entity, which we refer to as the QSPE or the issuer, to purchase customer receivables from us and to issue asset-backed and variable funding notes to third parties. We transfer receivables, consisting of retail installment and revolving account receivables extended to our customers, to the issuer in exchange for cash and subordinated securities. To finance its acquisition of these receivables, the issuer has issued notes to third parties.

We also derive revenues from repair services on the products we sell and from product delivery and installation services we provide to our customers. Additionally, acting as an agent for unaffiliated companies, we sell credit insurance and service maintenance agreements to protect our customers from credit losses due to death, disability, involuntary unemployment and property damage and product failure not covered by a manufacturers' warranty. We also derive revenues from the sale of extended service maintenance agreements, under which we are the primary obligor, to protect the customers after the original manufacturer's warranty or service maintenance agreement has expired.

Our business is moderately seasonal, with a slightly greater proportionate share of our revenues, pretax and net income realized during the quarter ending January 31, due primarily to the holiday selling season.

Executive Overview

This narrative is intended to provide an executive level overview of our operations for the three and nine months ended October 31, 2006. A detailed explanation of the changes in our operations for these periods as compared to the prior year is included under Results of Operations. As explained in that section, our pretax income for the quarter ended October 31, 2006 decreased approximately 18.5%, primarily as a result of higher selling, general and administrative expenses. Our pretax income for the nine months ended October 31, 2006 decreased approximately 2.4%, primarily as a result of higher selling, general and administrative expenses, partially offset by higher revenues and gross margin dollars. Increased interest income and higher other income partially offset the decline in pretax income. Some of the more specific items

impacting our operating and pretax income were:

- Same store sales for the quarter declined by 3.7% and for the nine months same store sales grew 6.5% over the same period for the prior year. While same store sales for the quarter declined, we were able to retain a large portion of the 23.3% same store sales growth experienced in the prior year period as a result of Hurricanes Rita and Katrina. The same store sales increase, in the markets not impacted by Hurricanes Rita and Katrina, was 0.1% for the quarter and 5.4% for the nine months. These other markets accounted for 79.7% of same store Product sales and Service maintenance agreement commissions during the three months ended October 31, 2006 and 78.7% of same store Product sales and Service maintenance agreement commissions during the nine months ended October 31, 2006.

- Our entry into the Dallas/Fort Worth and the South Texas markets and the addition of stores in our existing Houston and San Antonio markets had a positive impact on our revenues. We achieved approximately $4.9 million and $24.1 million of increases in product sales and service maintenance agreement commissions for the quarter and nine months ended October 31, 2006, respectively, from the new stores that were opened in these markets after February 1, 2005. Our plans provide for the opening of additional stores in existing markets during fiscal 2007 as we focus on opportunities in markets in which we have existing infrastructure.

- Deferred interest and "same as cash" plans continue to be an important part of our sales promotion plans and are utilized to provide a wide variety of financing to enable us to appeal to a broader customer base. For the three months and nine months ended October 31, 2006, $42.6 million, or 30.5%, and $113.7 million, or 25.3%, respectively, in gross product sales were financed by deferred interest and "same as cash" plans. For the comparable periods in the prior year gross product sales financed by deferred interest and "same as cash" sales were $38.5 million, or 27.4% and $119.0 million, or 29.8%. We expect to continue to offer extended term promotional credit in the future.

- Our gross margin for the quarter decreased from 35.5% to 35.3% for the three months ended October 31, 2006 when compared to the same period in the prior year, primarily as a result of reduced product margins to 20.8% for the three months ended October 31, 2006, from 21.6% in the prior year, and reduced front-end and retrospective Service Maintenance agreement commissions, due to lower sales penetration during the period and higher claims experience, partially offset by increased Finance charges and other income. Our gross margin for the nine months decreased from 35.7% to 34.2% when compared to the same period in the prior year, primarily due to the impact on securitization income of higher charge-offs in the credit portfolio, reduced retrospective Service Maintenance agreement commissions and a reduction in the gross margin on product sales to 20.6% for the nine months ended October 31, 2006, from 21.1% in the prior year.

- Finance charges and other increased 9.1% for the quarter and 1.9% for the nine months ended October 31, 2006, as compared to the double-digit Product sales growth for the nine-months ended October 31, 2006, as:

    - securitization income increased by 10.8% and 4.3%, respectively, for the quarter and nine months ended October 31, 2006. The quarterly comparison was impacted by the $0.9 million impairment charge recorded in the prior year period, which reduced the value of our interests in securitized assets for anticipated higher credit losses due to the impact of Hurricane Rita on our credit operations and an increase in

bankruptcy filings due to the new bankruptcy laws that took effect in October 2005. The nine-month comparison was also impacted by a 69.7% increase in credit losses, due to higher than expected losses primarily as a result of the disruption to our credit operations caused by Hurricane Rita. As a result of the increased credit losses incurred, during the three months ended July 31, 2006, due to the expectation of continued higher losses over the following six months, we recorded an impairment charge of $1.5 million, reducing the value of our interest in securitized assets.

- service maintenance agreement retrospective commissions for the quarter and the nine months ended October 31, 2006 decreased $0.2 million and $1.7 million, respectively, due to a change in the commission structure resulting in higher front-end commissions, which are included in Net sales and higher claims experience.

- During the three months ended October 31, 2006, Selling, general and administrative (SG&A) expense increased as a percent of revenues to 28.7% from 27.3% when compared to the prior year, primarily from increased occupancy cost, property taxes, professional fees related to the financial restatement, stock-based compensation and other small increases as a percent of revenues, while the prior year period included approximately $0.8 million of expenses incurred due to Hurricane Rita. During the nine months ended October 31, 2006, Selling, general and administrative expense decreased as a percent of revenues to 26.4% from 26.6% when compared to the prior year, primarily from reduced net advertising and insurance expenses as a percent of revenues, partially offset by increased property tax expense.

- Operating margin decreased from 8.0% to 6.3% for the three months ended October 31, 2006 when compared to the same period in the prior year due to reduced gross margin and increased SG&A expense. The factors above also affected the operating margin for the nine months ended October 31, 2006 which decreased from 9.0% during the same period last year to 7.6%.

- We adopted SFAS No. 123R, Share-Based Payment, during the quarter ended April 30, 2006. The adoption resulted in expenses totaling $0.4 million being recorded to SG&A during the quarter ended October 31, 2006 as compared to $0.2 million being recorded in the quarter ended October 31, 2005. The adoption resulted in expenses totaling $1.2 million being recorded to SG&A during the nine months ended October 31, 2006 as compared to $0.8 million being recorded in the nine months ended October 31, 2005.

- During the nine months ended October 31, 2006, the Company completed the sale of a building and the related land, resulting in the recognition of a gain of $0.7 million, which is reflected in Other (income) expense.

Operational Changes and Resulting Outlook

During the quarter, we opened a new store in the San Antonio market and during November 2006, we opened a new store in the Dallas/Fort Worth market. We have several other locations in Texas that we believe are promising and, along with new stores in existing markets, are in various stages of development for opening in fiscal year 2007.

The credit portfolio delinquency and charge-off statistics were negatively impacted by the effects of Hurricane Rita that hit the Gulf Coast during September of 2005. The hurricane impacted our customer's ability to pay on their accounts and hampered our credit collection operations, including payment processing delays caused by disruption in the mail service. The credit

collection operations were negatively affected by the loss of personnel, as some employees did not return to work, and by the increase in the number of delinquent accounts, resulting in increased workloads for the personnel that returned to work. To address the staffing issues, we have intensified our recruiting efforts to attract individuals to our Beaumont, Texas collection center and have opened a second collection center in Dallas, Texas. As we added these new employees, we reassigned our more experienced collectors to handle later-stage delinquent accounts. The new employees are not collecting with the same effectiveness as the more experienced collectors and the level of early stage delinquencies has increased. We believe this will improve as these new employees receive more training and become more experienced, and as we re-distribute our more experienced collectors through-out the delinquency stages. Non-storm factors that may have negatively affected delinquencies and charge-offs include the impact of the bankruptcy law change in October 2005 and other economic factors on our customers. Additionally, as the portfolio growth has slowed to 3.1% for the nine months ended October 31, 2006, from 14.4% for the prior year period, the 60-day delinquency rate of 7.1% has been negatively impacted by 80 basis points. Contrary to earlier predictions, the delinquency performance of the credit portfolio has not improved since January 31, 2006. However, loss rates have returned to historical levels and we expect the delinquency rates to return to historical levels over the next six months. If the delinquency rates do not improve, we may be required to book additional impairment charges in the future. See detail information regarding the delinquency status of the credit portfolio in Note 3 to the financial statements and additional information regarding our accounting for these assets under Application of Critical Accounting Policies - Transfers of Financial Assets.

On May 18, 2006, the Governor of Texas signed a tax bill that modifies the existing franchise tax, with the most significant change being the replacement of the existing base with a tax based on margin. Taxable margin is generally defined as total federal tax revenues minus the greater of (a) cost of goods sold or (b) compensation. The tax rate to be paid by retailers and wholesalers is 0.5% on taxable margin. This will result in an increase in taxes paid by us, as franchise taxes paid have totaled less than $50,000 per year for the last several years. The tax changes impacted earnings beginning in the quarter ended July 31, 2006. For the quarter and nine months ended, we accrued, net of federal tax benefit, approximately $173,000 and $290,000, respectively, in additional tax liability and initially recorded approximately $29,000 in net deferred tax assets as a result of the new margin tax. Going forward, we expect our effective tax rate on Income before income taxes to increase to between 36% and 37%, from an average of 35.1% over the past three fiscal years.

The consumer electronics industry depends on new products to drive same store sales increases. Typically, these new products, such as digital televisions, DVD players, digital cameras and MP3 players are introduced at relatively high price points that are then gradually reduced as the product becomes more mainstream. To sustain positive same store sales growth, unit sales must increase at a rate greater than the decline in product prices. The affordability of the product helps drive the unit sales growth. However, as a result of relatively short product life cycles in the consumer electronics industry, which limit the amount of time available for sales volume to increase, combined with rapid price erosion in the industry, retailers are challenged to maintain overall gross margin levels and positive same store sales. This has historically been our experience, and we continue to adjust our marketing strategies to address this challenge through the introduction of new product categories and new products within our existing categories.

Application of Critical Accounting Policies

In applying the accounting policies that we use to prepare our consolidated financial statements, we necessarily make accounting estimates that affect our reported amounts of assets, liabilities, revenues and expenses. Some of these accounting estimates require us to make assumptions about matters that are highly uncertain at the time we make the accounting estimates. We base these assumptions and the resulting estimates on authoritative pronouncements, historical information and other factors that we believe to be reasonable under the circumstances, and we evaluate these assumptions and estimates on an ongoing basis. We could reasonably use different accounting estimates, and changes in our accounting estimates could occur from period to period, with the result in each case being a material change in the financial statement presentation of our financial condition or results of operations. We refer to accounting estimates of this type as "critical accounting estimates." We believe that the critical accounting estimates discussed below are among those most important to an understanding of our consolidated financial statements as of October 31, 2006.

Transfers of Financial Assets. We transfer customer receivables to the QSPE that issues asset-backed securities to third party lenders using these accounts as collateral, and we continue to service these accounts after the transfer. We recognize the sale of these accounts when we relinquish control of the transferred financial asset in accordance with SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities. As we transfer the accounts, we record an asset representing the interest only strip which is the difference between the interest earned on customer accounts and the cost associated with financing and servicing the transferred accounts, including a provision for bad debts associated with the transferred accounts (on a revolving pool basis) discounted to a market rate of interest. The gain or loss recognized on these transactions is based on our best estimates of key assumptions, including forecasted credit losses based on actual portfolio experience over the past twelve months, payment rates, forward yield curves, costs of servicing the accounts and appropriate discount rates. The use of different estimates or assumptions could produce different financial results. For example, if we had assumed a 10.0% reduction in net interest spread (which might be caused by rising interest rates or reductions in rates charged on the accounts transferred), our interest in securitized assets would have been reduced by $5.4 million as of October 31, 2006, which may have an adverse affect on earnings. We recognize income from our interest in these transferred accounts as gains on the transfer of the asset, interest income and servicing fees. This income is recorded as Finance charges and other in our consolidated statements of operations. If the assumption used for estimating credit losses was increased by 0.5%, the impact to recorded Finance charges and other would have been a reduction in revenues and pretax income of $2.0 million.

Deferred Taxes. We have net deferred tax assets of approximately $2.2 million as of October 31, 2006. If we had assumed that the future tax rate at which these deferred items would reverse was 50 basis points higher than currently anticipated, we would have increased the net deferred tax asset and increased net income by approximately $30,000.

Intangible Assets. We have significant intangible assets related primarily to goodwill. The determination of related estimated useful lives and whether or not these assets are impaired involves significant judgments. Effective with the implementation of SFAS 142, we ceased amortizing goodwill and began testing potential impairment of this asset annually based on judgments regarding ongoing profitability and cash flow of the underlying assets. Changes in strategy or market conditions could significantly impact these judgments and require adjustments to recorded asset balances. For example, if we had reason to believe that our recorded goodwill had become impaired due to decreases in the fair market value of the underlying business, we would have to take a charge to income for that portion of goodwill that we believe is impaired. Our goodwill balance at October 31, 2006 was $9.6 million.

Property and Equipment. Our accounting policies regarding land, buildings, equipment and leasehold improvements include judgments regarding the estimated useful lives of such assets, the estimated residual values to which the assets are depreciated, and the determination as to what constitutes increasing the life of existing assets. These judgments and estimates may produce materially different amounts of depreciation and amortization expense that would be reported if different assumptions were used. These judgments may also impact the need to recognize an impairment charge on the carrying amount of these assets as the cash flows associated with the assets are realized. In addition, the actual life of the asset and residual value may be different from the estimates used to prepare financial statements in prior periods.

Revenue Recognition. Revenues from the sale of retail products are recognized at the time the product is delivered to the customer. Such revenues are recognized net of any adjustments for sales incentive offers such as discounts, coupons, rebates, or other free products or services and discounts of promotional credit sales that will extend beyond one year. We sell service maintenance agreements and credit insurance contracts on behalf of unrelated third parties. For contracts where the third parties are the obligors on the contract, commissions are recognized in revenues at the time of sale, and in the case of retrospective commissions, at the time that they are earned. Where we sell service maintenance renewal agreements in which we are deemed to be the obligor on the contract at the time of sale, revenue is recognized ratably, on a straight-line basis, over the term of the service maintenance agreement. These service maintenance agreements are renewal contracts that provide our customers protection against product repair costs arising after the expiration of the manufacturer's warranty and the third party obligor contracts. These agreements typically range from 12 months to 36 months. These agreements are separate units of accounting under Emerging Issues Task Force No. 00-21, Revenue Arrangements with Multiple Deliverables. The amount of service maintenance agreement revenue deferred at October 31, 2006 and January 31, 2006 was $3.9 million and $3.6 million, respectively, and is included in Deferred revenues and allowances in the accompanying balance sheets.

Vendor Allowances. We receive funds from vendors for price protection, product rebates, marketing and training and promotion programs which are recorded on the accrual basis as a reduction to the related product cost or advertising expense according to the nature of the program. We accrue rebates based on the satisfaction of terms of the program and sales of qualifying products even though funds may not be received until the end of a quarter or year. If the programs are related to product purchases, the allowances, credits or payments are recorded as a reduction of product cost; if the programs are related to promotion or marketing of the product, the allowances, credits, or payments are recorded as a reduction of advertising expense in the period in which the expense is incurred.

Accounting for Stock-Based Compensation. We adopted Statement of Financial Accounting Standards No. 123R, Share-Based Payment, effective February 1, 2006, using the modified retrospective application transition. This statement establishes standards for accounting for transactions in which an entity exchanges its equity instruments for goods or services, focusing primarily on accounting for transactions in which an entity obtains an employee's services. The statement requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments, based on the grant-date fair value of the award, and record that cost over the period during which the employee is required to provide service in exchange for the award. As a result of the adoption of this pronouncement, we retrospectively adjusted prior financial statements to record compensation expense, as previously reported in the notes to our financial statements, for all awards valued using fair-value

based methods. The impact of the adoption of this pronouncement is discussed in more detail in Note 1 to our financial statements.

Accounting for Leases. The accounting for leases is governed primarily by SFAS No. 13, Accounting for Leases. As required by the standard, we analyze each lease, at its inception, to determine whether it should be accounted for as an operating lease or a capital lease. Additionally, monthly lease expense for each operating lease is calculated as the average of all payments required under the minimum lease term, including rent escalations. Generally, the minimum lease term begins with the date we take possession of the property and ends on the last day of the minimum lease term, and includes all rent holidays, but excludes renewal terms that are at our option. Any tenant improvement allowances received are deferred and amortized into income as a reduction of lease expense on a straight line basis over the minimum lease term. The amortization of leasehold improvements is computed on a straight line basis over the shorter of the remaining lease term or the estimated useful life of the improvements. Effective

February 1, 2006 we implemented the requirements of FASB Staff Position No. 13-1, which addresses the accounting for rental costs associated with operating leases that are incurred during a construction period. As required by that guidance, we recognize as rental expense all rental costs associated with ground or building operating leases that are incurred during a construction period. That rental expense is included in income from continuing operations and is not capitalized.

Results of Operations

The following table sets forth certain statement of operations information as a percentage of total revenues for the periods indicated:

	Three Mo Ende October 2005
Revenues:	
Product sales	81.4 %
Service maintenance agreement commissions (net)	4.3
Service revenues	3.0
Total net sales	88.7
Finance charges and other	11.3
Total revenues	100.0
Costs and expenses:	
Cost of goods sold, including warehousing and occupancy cost	63.7
Cost of parts sold, including warehousing and occupancy cost	0.8
Selling, general and administrative expense	27.3
Provision for bad debts	0.2
Total costs and expenses	92.0

Operating income	8.0
Interest (income) expense, net	0.0
Other (income) expense, net	0.0
Income before income taxes	8.0
Provision for income taxes	2.8
Net income	5.2 %

The table above identifies several changes in our operations for the current quarter, including changes in revenue and expense categories expressed as a percentage of revenues. These changes are discussed in the Executive Overview, and in more detail in the discussion of operating results beginning in the analysis below.

Same store sales growth is calculated by comparing the reported sales by store for all stores that were open throughout a period to reported sales by store for all stores that were open throughout the prior year period. Sales from closed stores have been removed from each period. Sales from relocated stores have been included in each period because each store was relocated within the same general geographic market. Sales from expanded stores have been included in each period.

The presentation of gross margins may not be comparable to other retailers since we include the cost of our in-home delivery service as part of Selling, general and administrative expense. Similarly, we include the cost related to operating our purchasing function in Selling, general and administrative expense. It is our understanding that other retailers may include such costs as part of their cost of goods sold.

Three Months Ended October 31, 2006 Compared to Three Months Ended October 31, 2005

Revenues. Total revenues increased by $1.1 million, or 0.6%, from $172.6 million for the three months ended October 31, 2005 to $173.7 million for the three months ended October 31, 2006. The increase was attributable to an increase of $1.8 million, or 9.1%, in finance charges and other revenue, offset by decreases in net sales of $0.7 million, or 0.4%.

The $0.7 million decrease in net sales was made up of the following:

- a $5.4 million same store sales decrease of 3.7%, which was mitigated by our ability to retain a large portion of the 23.3% same store sales growth experienced in the prior year period as a result of Hurricanes Rita and Katrina. The same store sales increase in the markets not impacted by Hurricanes Rita and Katrina was 0.1%. These other markets accounted for 79.7% of same store Product sales and Service maintenance agreement commissions during the three months ended October 31, 2006. Service maintenance agreement (SMA) sales have declined due to lower sales penetration;

- a $4.9 million increase generated by six retail locations that were not open for three consecutive months in each period;

- a $1.0 million decrease resulted from an increase in discounts on extended-term promotional credit sales (those with terms longer than 12 months); and

- a $0.8 million increase resulted from an increase in service revenues.

The components of the $0.7 million decrease in net sales, were a $0.8 million decrease in Product sales and a $0.7 million decrease in service maintenance agreement commissions offset by a net increase in service revenues of $0.8 million. The $0.8 million decrease in product sales resulted from the following:

- approximately $7.7 million decrease attributable to decreases in unit sales, due to decreased appliances (primarily refrigeration), lawn and garden, and track sales, partially offset by increases in electronics, furniture and mattresses sales, and

- approximately $6.9 million increase attributable to increases in unit price points. The price point impact was driven by a shift to higher-priced high-efficiency laundry items, new higher priced refrigeration and increased delivery fees, partially offset by a slight decline in our mattresses and room air categories and the $1.0 million increase in discounts on extended-term promotional credit sales.

The following table presents the makeup of net sales by product category in each quarter, including service maintenance agreement commissions and service revenues, expressed both in dollar amounts and as a percent of total net sales. Classification of sales has been adjusted from previous filings to ensure comparability between the categories.

	Three Months Ended Octobe		
	2005		20
Category	Amount	Percent	Amount
Major home appliances	$ 55,803	36.4 %	$ 50,152
Consumer electronics	41,629	27.2	46,748
Track	21,218	13.9	18,358
Delivery	2,561	1.7	2,729
Lawn and garden	4,817	3.1	4,002
Mattresses	3,304	2.2	3,606
Furniture	3,731	2.4	7,927
Other	7,342	4.8	6,072
Total product sales	140,405	91.7	139,594
Service maintenance agreement commissions	7,506	4.9	6,845
Service revenues	5,157	3.4	5,951
Total net sales	$153,068	100.0 %	$152,390

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(1) This decrease is due to higher than normal demand for these products in the prior year due to consumers replacing appliances after Hurricanes Katrina and Rita.
(2) This increase is due to increased unit volume in the area of flat-panel and micro-display televisions, which also have higher price points than traditional tube and projection televisions.
(3) The decline in track sales (consisting largely of computers, computer peripherals, portable electronics and small appliances) is due primarily to reduced sales of computers and portable CRT televisions.
(4) This increase is due primarily to an increase in the fees charged for deliveries.
(5) A delayed selling season due to dry weather positively impacted this category in the prior year.
(6) This increase is due to increased emphasis on and improved merchandising and execution at our stores in the sale of this category.
(7) This increase is due to the increased emphasis on the sales of furniture, primarily sofas, recliners and entertainment centers, and new product lines added to this category.
(8) The decline in this category, which includes air conditioning, is due primarily to lower price points as the demand for smaller units increased.
(9) This decrease is due to the decrease in product sales and reduced sales penetration as we introduced products (furniture and mattresses) that are not SMA-eligible.
(10) This increase is driven by increased units in operation as we continue to grow product sales and an increase in the prices of parts used to repair higher-priced technology (flat-panel and micro-display televisions, etc.).

Revenue from Finance charges and other increased by approximately $1.8 million, or 9.1%, from $19.5 million for the three months ended October 31, 2005 to $21.3 million for the three months ended October 31, 2006. It increased while product sales declined, due primarily to an increase in securitization income of $1.6 million, or 10.8% and an increase in insurance commissions of $0.4 million, partially offset by a $0.2 million decrease in service maintenance agreement retrospective commissions. The securitization income comparison was impacted by a $0.9 million impairment charge recorded in the quarter ended October 31, 2005. The impairment charge reduced the value of our interests in securitized assets for anticipated higher credit losses due to the impact of Hurricane Rita on our credit operations and increased bankruptcy filings due to the new bankruptcy laws that took effect in October 2005. During the three months ended July 31, 2006, due to the expectation of continued higher losses over the following six months, we recorded an impairment charge of $1.5 million, reducing the value of our interest in securitized assets. The 69.2% increase in net credit losses experienced during the quarter ended October 31, 2006, was in-line with our expectations at the time we recorded the impairment charge. This impairment charge was based on an estimated charge-off rate of approximately 3.6% over the six month period ending January 31, 2007. The charge-off rate used in the securitized asset valuation is expected to return to the level of the historical charge-off rate assumption of 3.0% at the beginning of our next fiscal year. Additionally, securitization income has been negatively impacted by increased interest cost on the borrowings of the QSPE, due to rising interest rates, and slower growth in the credit portfolio, which impacts the interest income earned by the QSPE.

Cost of Goods Sold. Cost of goods sold, including warehousing and occupancy cost, increased by $0.6 million, or 0.5%, from $110.0 million for the three months ended October 31, 2005 to $110.6 million for the three months ended October 31, 2006. This increase was higher than the 0.6% decrease in Product

sales during the three months ended October 31, 2006. Cost of products sold increased to 79.2% of Product sales in the quarter ended October 31, 2006, as compared to 78.4% in the quarter ended October 31, 2005. The increase in Cost of goods sold as a percentage of Product sales was primarily as a result of higher product and warehousing costs, which grew faster than sales.

Cost of Parts Sold. Cost of parts sold, including warehousing and occupancy cost, increased approximately $0.5 million, or 37.5%, for the three months ended October 31, 2006 as compared to the three months ended October 31, 2005, due to a 41.7% increase in parts sales.

Selling, General and Administrative Expense. Selling, general and administrative expense increased by $2.5 million, or 5.4%, from $47.2 million for the three months ended October 31, 2005 to $49.7 million for the three months ended October 31, 2006. The increase in expense resulted primarily from increased occupancy cost, property taxes, and professional fees related to the financial restatement. The prior year period included approximately $0.8 million of expenses incurred due to Hurricane Rita. We adopted SFAS No. 123R, Share-Based Payment, effective February 1, 2006. The adoption resulted in expenses totaling $0.4 million being recorded to SG&A during the quarter ended October 31, 2006 as compared to $0.2 million being recorded in the quarter ended October 31, 2005.

Provision for Bad Debts. The provision for bad debts on non-credit portfolio receivables and credit portfolio receivables retained by the Company and not transferred to the QSPE increased by $0.2 million, during the three months ended October 31, 2006, as compared to the three months ended October 31, 2005, primarily as a result of provision adjustments due to increased credit losses. See Note 3 to the financial statements for information regarding the performance of the credit portfolio.

Interest (Income) Expense, net. Net interest (income) expense improved by $215,000, from net interest expense of $74,000 for the three months ended October 31, 2005 to net interest income of $141,000 for the three months ended October 31, 2006. The net improvement in interest (income) expense was primarily attributable to increased interest income from invested funds of approximately $132,000. The remaining change of $83,000 resulted from lower average outstanding debt balances and capitalization of interest expense on construction in progress.

Other (Income) Expense, net. Other (income) expense, net declined by $8,000, from net income of $27,000 for the three months ended October 31, 2005, to net income of $19,000 for the three months ended October 31, 2006.

Provision for Income Taxes. The provision for income taxes decreased by $0.8 million, or 17.2%, from $4.8 million for the three months ended October 31, 2005 to $4.0 million for the three months ended October 31, 2006. The decrease in the Provision for income taxes is attributable to lower Income before income taxes and adjustments to reconcile final tax returns to previous estimates, partially offset by the impact of the new Texas margin tax. Our effective tax rate increased to 35.9% from 35.4% due to the impact of the Texas margin tax.

Net Income. As a result of the above factors, Net income decreased $1.7 million, or 19.2%, from $8.9 million for the three months ended October 31, 2005 to $7.2 million for the three months ended October 31, 2006.

Nine Months Ended October 31, 2006 Compared to Nine Months Ended October 31, 2005

Revenues. Total revenues increased by $53.0 million, or 10.7%, from $495.1 million for the nine months ended October 31, 2005 to $548.1 million for the nine months ended October 31, 2006. The increase was attributable to increases

in net sales of $51.9 million, or 11.9%, and a increase of $1.1 million, or 1.9%, in finance charges and other revenue.

The $51.9 million increase in net sales was made up of the following:

- a $26.7 million same store sales increase of 6.5%. The same store sales increase in the markets not impacted by Hurricanes Rita and Katrina was 5.4%. These other markets accounted for 78.7% of same store Product sales and Service maintenance agreement commissions during the nine months ended October 31, 2006. Additionally, as a result of changes in the commission structure on our third-party service maintenance agreement (SMA) contracts, beginning July 2005, we began realizing the benefit of increased front-end commissions on SMA sales, which increased net sales by approximately $0.9 million, (offsetting this increase is a decrease in retrospective commissions which is reflected in Finance charges and other);

- a $24.1 million increase generated by nine retail locations that were not open for nine consecutive months in each period;

- a $1.0 million decrease resulted from an increase in discounts on extended-term promotional credit sales (those with terms longer than 12 months); and

- a $2.1 million increase resulted from an increase in service revenues.

The components of the $51.9 million increase in net sales were a $50.2 million increase in product sales and a $1.7 million net increase in service maintenance agreement commissions and service revenues. The $50.2 million increase in product sales resulted from the following:

- approximately $26.4 million was attributable to increases in unit sales, due to increased appliances, consumer electronics (especially plasma and LCD televisions), and furniture sales, partially offset by a decline in track sales, and

- approximately $23.8 million was attributable to increases in unit price points. The price point impact was driven by a shift to higher-priced track items and increased delivery fees, as well as consumers selecting higher priced appliance products, including high-efficiency washers and dryers and stainless kitchen appliances, partially offset by a decline in electronics as prices for new technology erode and the $1.0 million increase in discounts on extended-term promotional credit sales.

The following table presents the makeup of net sales by product category for each period presented, including service maintenance agreement commissions and service revenues, expressed both in dollar amounts and as a percent of total net sales. Classification of sales has been adjusted from previous filings to ensure comparability between the categories.

Category	Nine Months Ended Octobe		
	2005		200
	Amount	Percent	Amount
Major home appliances	$148,983	34.2 %	$165,445
Consumer electronics	125,011	28.7	146,799
Track	65,183	15.0	61,820
Delivery	6,960	1.6	8,488
Lawn and garden	16,042	3.7	15,695
Mattresses	9,306	2.1	13,610
Furniture	10,500	2.4	21,577
Other	16,562	3.8	15,316
Total product sales	398,547	91.5	448,750
Service maintenance agreement commissions	22,238	5.1	21,875
Service revenues	15,066	3.4	17,107
Total net sales	$435,851	100.0 %	$487,732

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(1) These increases are consistent with overall increase in product sales and improved unit prices.

(2) The decline in track sales (consisting largely of computers, computer peripherals, portable electronics and small appliances) is due primarily to reduced sales of computers and portable CRT televisions.

(3) This increase is due primarily to the increase in total product sales, as well as an increase in the fees charged for deliveries.

(4) A slower late-summer selling season due to dry weather impacted this category.

(5) This increase is due to increased emphasis on and improved merchandising and execution at our stores in the sale of this category.

(6) This increase is due to the increased emphasis on the sales of furniture, primarily sofas, recliners and entertainment centers, and new product lines added to this category.

(7) The decline in this category, which includes air conditioning, is due primarily to lower price points as the demand for smaller units increased.

(8) This decrease is due to reduced sales penetration as we introduced products (furniture and mattresses) that are not SMA-eligible.

(9) This increase is driven by increased units in operation as we continue to grow product sales and an increase in the prices of parts used to repair higher-priced technology (flat-panel and micro-display televisions, etc.).

Revenue from Finance charges and other increased by approximately $1.2 million, or 1.9%, from $59.2 million for the nine months ended October 31, 2005, to $60.4 million for the nine months ended October 31, 2006. The increase was due to a $1.8 million increase in securitization income and a $1.1 million increase in insurance commissions, partially offset by a $1.7 million decrease in service maintenance agreement commissions and other. Securitization income was impacted by a 69.7% increase in net credit losses in the nine months ended October 31, 2006 as compared to the nine months ended October 31, 2005. The increased net credit losses were due to higher than expected losses primarily as a result of the disruption to our credit operations caused by Hurricane Rita. During the quarter ended July 31, 2006, due to the expectation of continued higher losses over the following six months, we recorded an impairment charge of $1.5 million, reducing the value of our interest in securitized assets. This

impairment charge is based on an estimated charge-off rate of approximately 3.6% over the six month period. The charge-off rate used in the securitized asset valuation is expected to return to the level of the historical charge-off rate assumption of 3.0% at the beginning of our next fiscal year. Securitization income for the nine months ended October 31, 2005 was impacted by a $0.9 million impairment charge, which reduced the value of our interests in securitized assets for anticipated higher credit losses due to the impact of Hurricane Rita on our credit operations and an increase in bankruptcy filings due to the new bankruptcy law that took effect in October 2005. Additionally, securitization income has been negatively impacted by increased interest cost on the borrowings of the QSPE, due to rising interest rates, and slower growth in the credit portfolio, which impacts the interest income earned by the QSPE.

Cost of Goods Sold. Cost of goods sold, including warehousing and occupancy cost, increased by $41.6 million, or 13.2%, from $314.5 million for the nine months ended October 31, 2005 to $356.1 million for the nine months ended October 31, 2006. This increase was higher than the 12.6% increase in Product sales during the nine months ended October 31, 2006. Cost of products sold increased to 79.4% of Product sales in the nine months ended October 31, 2006, as compared to 78.9% in the nine months ended October 31, 2005. The increase in Cost of goods sold as a percentage of Product sales was primarily as a result of higher product and warehousing costs, which grew faster than sales.

Cost of Parts Sold. Cost of parts sold, including warehousing and occupancy cost, increased approximately $1.0 million, or 26.2%, for the nine months ended October 31, 2006 as compared to the nine months ended October 31, 2005, due to a 36.6% increase in parts sales.

Selling, General and Administrative Expense. While Selling, general and administrative expense increased by $13.0 million, or 9.8%, from $131.8 million for the nine months ended October 31, 2005 to $144.8 million for the nine months ended October 31, 2006, it decreased as a percentage of total revenue from 26.6% to 26.4%. The decrease in expense as a percentage of total revenues resulted primarily from reduced net advertising and insurance expenses as a percent of revenues, partially offset by increased property tax expense. We adopted SFAS No. 123R, Share-Based Payment, effective February 1, 2006. The adoption resulted in expenses totaling $1.2 million being recorded to SG&A during the nine months ended October 31, 2006 as compared to $0.8 million being recorded in the nine months ended October 31, 2005.

Provision for Bad Debts. The provision for bad debts on non-credit portfolio receivables and credit portfolio receivables retained by the Company and not transferred to the QSPE increased by $0.3 million, during the nine months ended October 31, 2006, as compared to the nine months ended October 31, 2005, primarily as a result of provision adjustments due to increased credit losses.

Interest (Income) Expense, net. Net interest (income) expense improved by $1.0 million, from net interest expense of $0.5 million for the nine months ended October 31, 2005 to net interest income of $0.5 million for the nine months ended October 31, 2006. The net improvement in interest (income) expense was primarily attributable to:

- the expiration of $20.0 million of our interest rate hedges and the discontinuation of hedge accounting resulted in a net decrease in interest expense of approximately $244,000; and
- increased interest income from invested funds of approximately $510,000.

The remaining change of $246,000 resulted from lower average outstanding debt balances and capitalization of interest expense on construction in progress.

Other (Income) Expense, net. Other (income) expense, net improved by $780,000, from net expense of $7,000 for the nine months ended October 31, 2005, to net income of $773,000 for the nine months ended October 31, 2006. This change was primarily the result of a $0.7 million gain recognized on the sale of a building and the related land.

Provision for Income Taxes. The provision for income taxes decreased by $0.3 million, or 2.4%, from $15.4 million for the nine months ended October 31, 2005 to $15.1 million for the nine months ended October 31, 2006. The decrease in the Provision for income taxes is attributable to lower Income before income taxes, state tax refunds received during the period and adjustments to reconcile final tax returns to previous estimates, partially offset by additional tax expense from the new Texas margin tax. The impact of the new Texas margin tax was partially offset by the one-time benefit of deferred tax assets recorded as a result of the new tax. Our effective rate for both periods was 35.3% as the refunds and return adjustments were offset by the impact of the Texas margin tax.

Net Income. As a result of the above factors, Net income decreased $0.7 million, or 2.4%, from $28.3 million for the nine months ended October 31, 2005 to $27.6 million for the nine months ended October 31, 2006.

Liquidity and Capital Resources

Current Activities

Historically we have financed our operations through a combination of cash flow generated from operations, and external borrowings, including primarily bank debt, extended terms provided by our vendors for inventory purchases, acquisition of inventory under consignment arrangements and transfers of receivables to our asset-backed securitization facilities.

As of October 31, 2006, we had approximately $39.4 million in excess cash, the majority of which was generated through the operations of the Company. In addition to the excess cash, we had $48.1 million under our revolving line of credit, net of standby letters of credit issued, and $8.0 million under our unsecured bank line of credit available to us for general corporate purposes, $31.0 million under extended vendor terms for purchases of inventory and $221.0 million in commitments available to our QSPE for the transfer of receivables.

In its regularly scheduled meeting on August 24, 2006, our Board of Directors authorized the repurchase of up to $50 million of our common stock, dependent on market conditions and the price of the stock. We expect to fund these purchases with a combination of excess cash, cash flow from operations, borrowings under our revolving credit facilities and proceeds from the sale of owned properties. Through October 31, 2006, we had spent $0.7 million under this authorization to acquire 33,800 shares of our common stock.

Effective August 28, 2006, we entered into an amendment to our $50 million revolving credit facility with the existing lenders. The amendment increases our restricted payment capacity, which includes payments for repurchases of capital stock, from $25 million to $50 million. There were no other modifications of the Credit Agreement.

A summary of the significant financial covenants that govern our bank credit facility compared to our actual compliance status at October 31, 2006, is

presented below:

	Actua
Debt service coverage ratio must exceed required minimum	4.24 to
Total adjusted leverage ratio must be lower than required maximum	1.56 to
Consolidated net worth must exceed required minimum	$275.4 m
Charge-off ratio must be lower than required maximum	0.03 to
Extension ratio must be lower than required maximum	0.03 to
Thirty-day delinquency ratio must be lower than required maximum	0.09 to

Note: All terms in the above table are defined by the bank credit facility and may or may not agree directly to the financial statement captions in this document.

We will continue to finance our operations and future growth through a combination of cash flow generated from operations and external borrowings, including primarily bank debt, extended vendor terms for purchases of inventory, acquisition of inventory under consignment arrangements and the QSPE's asset-backed securitization facilities. Based on our current operating plans, we believe that cash generated from operations, available borrowings under our bank credit facility and unsecured credit line, extended vendor terms for purchases of inventory, acquisition of inventory under consignment arrangements and access to the unfunded portion of the variable funding portion of the QSPE's asset-backed securitization program will be sufficient to fund our operations, store expansion and updating activities, stock repurchases, if any, and capital programs through at least January 31, 2007. However, there are several factors that could decrease cash provided by operating activities, including:

- reduced demand for our products;
- more stringent vendor terms on our inventory purchases;
- loss of ability to acquire inventory on consignment;
- increases in product cost that we may not be able to pass on to our customers;
- reductions in product pricing due to competitor promotional activities;
- changes in inventory requirements based on longer delivery times of the manufacturers or other requirements which would negatively impact our delivery and distribution capabilities;
- increases in the retained portion of our receivables portfolio under our current QSPE's asset-backed securitization program as a result of changes in performance or types of receivables transferred (promotional versus non-promotional and primary versus secondary portfolio);
- inability to expand our capacity for financing our receivables portfolio under new or replacement QSPE asset-backed securitization programs or a requirement that we retain a higher percentage of the

credit portfolio under such new programs;

- increases in program costs (interest and administrative fees relative to our receivables portfolio associated with the funding of our receivables); and

- increases in personnel costs.

During the nine months ended October 31, 2006, net cash provided by operating activities decreased $40.7 million from $51.8 million provided in the 2005 period to $11.1 million used in the 2006 period. The net decrease in cash provided from operations resulted primarily from the timing of payments of accounts payable and federal income and employment tax payments. We had obtained extended payment terms from several of our vendors due to the impact of hurricanes in the prior fiscal year. Federal income and employment tax payment deadlines after Hurricane Rita were also deferred until February 28, 2006. Those extended terms ended and deadlines were reached in the nine months ended October 31, 2006 and we were required to satisfy those obligations, which negatively impacted our operating cash flows by approximately $18.9 million. Also impacting accounts payable timing were reduced receipts of product during the month of October 2006, resulting in payment due dates on much of the on-hand inventory at October 31, 2006, being met and satisfied. Additionally, during the nine months ended October 31, 2006, cash flow was benefited by the financing transaction completed by the QSPE which provided additional cash, which reduced our retained interest.

As noted above, we offer promotional credit programs to certain customers that provide for "same as cash" or deferred interest interest-free periods of varying terms, generally three, six, or 12 months; in fiscal year 2005 we increased these terms to include 18, 24 and 36 months. The various "same as cash" promotional accounts and deferred interest program accounts are eligible for securitization up to the limits provided for in our securitization agreements. This limit is currently 30.0% of eligible securitized receivables. If we exceed this 30.0% limit, we would be required to use some of our other capital resources to carry the unfunded balances of the receivables for the promotional period. The percentage of eligible securitized receivables represented by promotional receivables was 18.2% as of October 31, 2006. At October 31, 2005, this percentage, computed on a consistent basis with the October 31, 2006 calculation, would have been 20.8%. The weighted average promotional period was 12.4 months and 11.7 months for promotional receivables outstanding as of October 31, 2005 and 2006, respectively. The weighted average remaining term on those same promotional receivables was 7.7 months as of both October 31, 2005 and 2006. While overall these promotional receivables have a much shorter weighted average term than non-promotional receivables, we receive less income on these receivables, resulting in a reduction of the net interest margin used in the calculation of the gain on the sale of receivables.

Net cash used by investing activities decreased by $0.7 million, from $14.1 million for the nine months ended October 31, 2005 to $13.4 million for the nine months ended October 31, 2006. The decrease in cash used in investing activities resulted primarily from the sales of property and equipment, partially offset by increased purchases of property and equipment. The cash expended for property and equipment was used primarily for construction of new stores and the reformatting of existing stores to better support our current product mix. Based on current plans, we expect to increase expenditures for property and equipment in fiscal 2007 as we open additional stores, including ownership and development of shopping centers that will feature our store, as compared to fiscal 2006. Additionally, we intend to sell and lease-back certain of the properties we currently own, in order to provide cash flow for funding our growth and stock repurchase plans.

Net cash from financing activities increased by $9.9 million from $8.6 million used during the nine months ended October 31, 2005 to $1.3 million provided during the nine months ended October 31, 2006. The increase in cash provided by financing activities resulted primarily from decreases in payments on various debt instruments of $10.5 million. Also benefiting cash flow from financing activities was increased proceeds from stock issued under employee benefit plans. During the nine months ended October 31, 2006, we used $0.7 million to purchase 33,800 shares of our common stock.

Off-Balance Sheet Financing Arrangements

Since we extend credit in connection with a large portion of our retail, service maintenance and credit insurance sales, we have created a qualified special purpose entity, which we refer to as the QSPE or the issuer, to purchase customer receivables from us and to issue asset-backed and variable funding notes to third parties to obtain cash for these purchases. We transfer receivables, consisting of retail installment contracts and revolving accounts extended to our customers, to the issuer in exchange for cash and subordinated, unsecured promissory notes. To finance its acquisition of these receivables, the issuer has issued the notes and bonds described below to third parties. The unsecured promissory notes issued to us are subordinate to these third party notes and bonds.

In August 2006, the issuer entered into an amendment of the Series A note to increase the total available funding to $300 million from $250 million, divided into a $100 million 364-day tranche, and a $200 million tranche that expires in August 2011. The Company's QSPE closed and consummated an offering, pursuant to Rule 144A and Regulation S under the Securities Act of 1933, of $150 million of asset-backed fixed-rate notes (Series 2006A bonds), the net proceeds of which were used primarily to provide the QSPE with additional capacity, fund a required $6.0 million cash reserve account and to reduce the amount outstanding under the existing Series A variable funding note. The proceeds of the new issuance provide the issuer additional capacity for the purchase of our receivables and to make the $10 million monthly principal payments due on the Series B bonds beginning in October 2006.

At October 31, 2006, the issuer had issued three series of notes and bonds: a Series A variable funding note with a total availability of $300 million purchased by Three Pillars Funding LLC, three classes of Series B bonds with an aggregate amount outstanding of $190 million, of which $8.0 million was required to be placed in a restricted cash account for the benefit of the bondholders, and three classes of Series 2006A bonds with an aggregate amount outstanding of $150 million, of which $6.0 million was required to be placed in a restricted cash account for the benefit of the bondholders. If the net portfolio yield, as defined by agreements, falls below 5.0%, then the issuer may be required to fund additions to the cash reserves in the restricted cash accounts. At October 31, 2006, the net portfolio yield was in compliance with this requirement. Private institutional investors, primarily insurance companies, purchased the Series B bonds at a weighted fixed rate of 5.25% and Series 2006A bonds at a weighted fixed rate of 5.75%.

In August 2006, certain of the existing transaction documents related to the activities of the QSPE were amended. The following is a summary of the key amendments:

- increase our consolidated net worth requirement from $30 million to $150 million;
- add certain return mail procedures to the internal accounting control procedures and processing functions report delivered by independent

accountants pursuant to the servicing agreement;

- change the definition of "Eligible Installment Contract Receivable" under the base indenture to allow up to 27.5% of all receivables by outstanding principal balance to consist of installment contract receivables of the secondary portfolio (formerly 25% of such receivables were permitted);

- change the definition of "Eligible Installment Contract Receivable" and "Eligible Revolving Charge Receivable" under the base indenture to allow up to 5.0% of the amount or number of installment contract and revolving charge receivables, whichever occurs first, to have a maximum repayment period and cash option period exceeding thirty-six months but no more than forty-eight months (secondary portfolio maximum term remains thirty-six months);

- change certain definitions under the series supplements for the Series A notes and the Series B bonds, including changes to the series supplements for the Series A notes that have the effect of increasing the current level of funding available to the issuer; and

- provide for the issuer's issuance of additional asset-backed notes and obtain additional commitments under the Series A notes upon the occurrence of certain events related to the expiration of any commitment under the Series A notes or the amount of the commitment used under the Series A notes.

We continue to service the transferred accounts for the QSPE, and we receive a monthly servicing fee, so long as we act as servicer, in an amount equal to ..0025% multiplied by the average aggregate principal amount of receivables serviced plus the amount of average aggregate defaulted receivables. The issuer records revenues equal to the interest charged to the customer on the receivables less losses, the cost of funds, the program administration fees paid in connection with either Three Pillars Funding LLC, the Series B or Series 2006A bond holders, the servicing fee and additional earnings to the extent they are available.

After August, 2006 amendment, the Series A variable funding note now permits the issuer to borrow funds up to $300 million to purchase receivables from us, thereby functioning as a "basket" to accumulate receivables. As issuer borrowings under the Series A variable funding note approach $300 million, the issuer is required to request an increase in the Series A amount or issue a new series of bonds and use the proceeds to pay down the then outstanding balance of the Series A variable funding note, so that the basket will once again become available to accumulate new receivables or meet other obligations required under the transaction documents. As of October 31, 2006, borrowings under the Series A variable funding note were $79.0 million.

We are not directly liable to the lenders under the asset-backed securitization facility. If the issuer is unable to repay the Series A note, Series B bonds and Series 2006A bonds due to its inability to collect the transferred customer accounts, the issuer could not pay the subordinated notes it has issued to us in partial payment for transferred customer accounts, the Series B and Series 2006A bond holders could claim the balance in its $14.0 million restricted cash account. We are also contingently liable under a $20.0 million letter of credit that secures our performance of our obligations or services under the servicing agreement as it relates to the transferred assets that are part of the asset-backed securitization facility.

The issuer is subject to certain affirmative and negative covenants contained in the transaction documents governing the Series A variable funding note and the Series B and Series 2006A bonds, including covenants that restrict, subject to specified exceptions: the incurrence of non-permitted indebtedness and other obligations and the granting of additional liens; mergers, acquisitions, investments and disposition of assets; and the use of proceeds of the program. The issuer also makes representations and warranties relating to compliance with certain laws, payment of taxes, maintenance of its separate legal entity, preservation of its existence, protection of collateral and financial reporting. In addition, the program requires the issuer to maintain a minimum net worth.

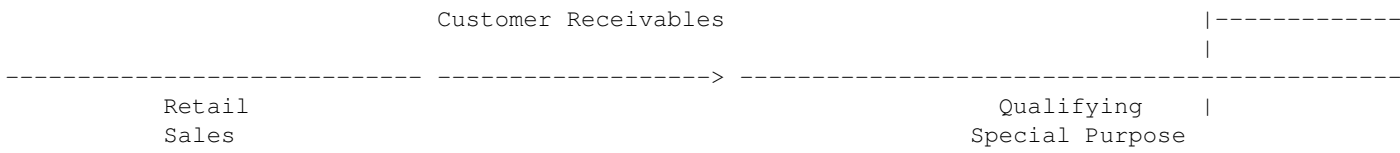
A summary of the significant financial covenants that govern the Series A variable funding note compared to actual compliance status at October 31, 2006, is presented below:

	As r
Issuer interest must exceed required minimum	$46.4
Gross loss rate must be lower than required maximum	
Net portfolio yield must exceed required minimum	
Payment rate must exceed required minimum	

Note: All terms in the above table are defined by the asset backed credit facility and may or may not agree directly to the financial statement captions in this document.

Events of default under the Series A variable funding note and the Series B and Series 2006A bonds, subject to grace periods and notice provisions in some circumstances, include, among others: failure of the issuer to pay principal, interest or fees; violation by the issuer of any of its covenants or agreements; inaccuracy of any representation or warranty made by the issuer; certain servicer defaults; failure of the trustee to have a valid and perfected first priority security interest in the collateral; default under or acceleration of certain other indebtedness; bankruptcy and insolvency events; failure to maintain certain loss ratios and portfolio yield; change of control provisions and certain other events pertaining to us. The issuer's obligations under the program are secured by the receivables and proceeds.

Securitization Facilities
We finance most of our customer receivables through asset-backed securitization facilities


Customer Receivables
Retail
Sales
Qualifying
Special Purpose