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CONNS INC
Form 10-Q/A
October 04, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A
AMENDMENT NO. 2

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

For the quarterly period ended April 30, 2006 Commission File Number 000-50421

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

A Delaware Corporation
(State or other jurisdiction of
incorporation or organization)

06-1672840
(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 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 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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of May 30, 2006:

Class	Outstanding
----- Common stock, \$.01 par value per share	----- 23,665,335

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EXPLANATORY NOTE

Correction of Consolidated Financial Statements

We are amending our Quarterly Report on Form 10-Q/A (the "Original Filing") for the quarter ended April 30, 2006, to correct a mistake in our consolidated balance sheet as of April 30, 2006 filed with our Quarterly Report on Form 10-Q/A for the quarter ended April 30, 2006, filed with the Securities and Exchange Commission on September 15, 2006. This amendment and correction are necessitated by a typographical error in the consolidated balance sheets, specifically in the line entitled "Accrued compensation and related expenses" and the resulting total lines.

All of the information in this Form 10-Q/A is as of April 30, 2006 and does not reflect any subsequent information or events other than the correction indicated above. Only the following items have been amended as a result of the correction:

Part I - Item 1 - Financial Statements, Consolidated Balance Sheets, Page 1

Other than as discussed above, this Form 10-Q/A does not reflect events occurring after the filing of the Original Filing or modify or update disclosures (including the exhibits to the Original Filing) affected by subsequent events. Accordingly, this Form 10-Q/A should be read in conjunction with our periodic filings made with the Securities and Exchange Commission subsequent to the date of the Original Filing, including any amendments to those filings. In addition, this Form 10-Q/A includes updated certifications from our Chief Executive Officer and Chief Financial Officer as Exhibits 31.1, 31.2, and 32.1.

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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 9)

	January 31, 2006	April 30, 2006
Assets	-----	----- (unaudited)
Current assets		
Cash and cash equivalents	\$ 45,176	\$ 30,924
Accounts receivable, net	23,542	26,882
Interests in securitized assets	139,282	139,022
Inventories	73,987	80,527
Prepaid expenses and other assets	4,004	4,510
	-----	-----
Total current assets	285,991	281,865
Non-current deferred income tax asset	2,464	2,881
Property and equipment		
Land	6,671	6,671
Buildings	7,084	12,946
Equipment and fixtures	9,612	10,198
Transportation equipment	3,284	3,105
Leasehold improvements	65,507	66,057
	-----	-----
Subtotal	92,158	98,977
Less accumulated depreciation	(37,332)	(40,149)
	-----	-----

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Total property and equipment, net	54,826	58,828
Goodwill, net	9,617	9,617
Debt issuance costs and other assets, net	260	268
	-----	-----
Total assets	\$ 353,158	\$ 353,459
	=====	=====
Liabilities and Stockholders' Equity		
Current liabilities		
Current portion of long-term debt	\$ 136	\$ -
Accounts payable	40,920	36,884
Accrued compensation and related expenses	18,847	10,645
Accrued expenses	17,380	17,062
Income taxes payable	8,794	5,602
Deferred income taxes	1,343	3,334
Deferred revenues and allowances	8,498	8,693
	-----	-----
Total current liabilities	95,918	82,220
Long-term debt	-	-
Non-current deferred income tax liability	903	960
Deferred gain on sale of property	476	435
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 23,665,335 shares issued and outstanding at January 31, 2006 and April 30, 2006, respectively)	236	237
Additional paid-in capital	89,027	90,551
Accumulated other comprehensive income	10,492	11,001
Retained earnings	156,106	168,055
	-----	-----
Total stockholders' equity	255,861	269,844
	-----	-----
Total liabilities and stockholders' equity	\$ 353,158	\$ 353,459
	=====	=====

See notes to consolidated financial statements.

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Conn's, Inc.
CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)
(in thousands, except earnings per share)
(As Adjusted, See Note 1 and As Restated, See Note 9)

Three Months Ended
April 30,

2005 2006

Revenues

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Product sales	\$ 127,275	\$ 158,509
Service maintenance agreement commissions, net	6,884	7,967
Service revenues	4,775	5,229
	-----	-----
Total net sales	138,934	171,705
Finance charges and other	18,985	20,483
	-----	-----
Total revenues	157,919	192,188
Cost and expenses		
Cost of goods sold, including warehousing and occupancy costs	100,917	125,729
Cost of parts sold, including warehousing and occupancy costs	1,225	1,565
Selling, general and administrative expense	39,739	46,664
Provision for bad debts	468	43
	-----	-----
Total cost and expenses	142,349	174,001
	-----	-----
Operating income	15,570	18,187
Interest (income) expense, net	355	(184)
Other (income) expense, net	6	(33)
	-----	-----
Income before income taxes	15,209	18,404
Provision for income taxes		
Current	7,543	5,086
Deferred	(2,202)	1,369
	-----	-----
Total provision for income taxes	5,341	6,455
	-----	-----
Net income	\$ 9,868	\$ 11,949
	=====	=====
Earnings per share		
Basic	\$ 0.42	\$ 0.51
Diluted	\$ 0.42	\$ 0.49
Average common shares outstanding		
Basic	23,307	23,596
Diluted	23,775	24,448

See notes to consolidated financial statements.

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	Common Stock		Accum. Other Compre- hensive Income	Additional Paid-in Capital	Retained Earnings	Total
	Shares	Amount				
Balance January 31, 2006	23,572	\$ 236	\$ 10,492	\$ 89,027	\$ 156,106	\$ 255,
Exercise of options to acquire 91,698 shares of common stock	92	1		938		
Issuance of 2,073 shares of common stock under Employee Stock Purchase Plan	2			60		
Stock-based compensation				393		
Tax benefit from options exercised				133		
Net income					11,949	11,
Adjustment of fair value of securitized assets (net of tax of \$264), net of reclassification adjustments of \$3,330 (net of tax of \$1,801)			509			
Total comprehensive income						12,
Balance April 30, 2006	23,666	\$ 237	\$ 11,001	\$ 90,551	\$ 168,055	\$ 269,

See notes to consolidated financial statements.

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Conn's, Inc.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)
(in thousands)
(As Adjusted, See Note 1 and As Restated, See Note 9)

	Three Months Ended April 30,	
	2005	2006
Cash flows from operating activities		
Net income	\$ 9,868	\$ 11,949
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	2,645	3,006
Amortization	(59)	(97)
Provision for bad debts	521	43
Stock-based compensation	263	393
Excess tax benefits from stock-based compensation	-	(133)
Discounts on promotional credit	111	217

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Accretion from interests in securitized assets	(4,897)	(5,131)
Provision for deferred income taxes	(2,202)	1,369
Loss (Gain) from sale of property and equipment	6	(33)
Loss from derivatives	69	-
Changes in operating assets and liabilities:		
Accounts receivable	3,376	2,563
Inventory	(7,048)	(6,541)
Prepaid expenses and other assets	251	(506)
Accounts payable	2,593	(4,036)
Accrued expenses	(536)	(8,520)
Income taxes payable	6,584	(3,192)
Deferred revenue and allowances	111	265
	-----	-----
Net cash provided by (used in) operating activities	11,656	(8,384)
	-----	-----
Cash flows from investing activities		
Purchase of property and equipment	(3,273)	(7,023)
Proceeds from sale of property	11	48
	-----	-----
Net cash used in investing activities	(3,262)	(6,975)
	-----	-----
Cash flows from financing activities		
Proceeds from stock issued under employee benefit plans	755	1,132
Excess tax benefits from stock-based compensation	-	133
Borrowings under lines of credit	25,800	3,200
Payments on lines of credit	(36,300)	(3,200)
Increase in debt issuance costs	-	(22)
Payment of promissory notes	(7)	(136)
	-----	-----
Net cash provided by (used in) financing activities	(9,752)	1,107
	-----	-----
Net change in cash	(1,358)	(14,252)
Cash and cash equivalents		
Beginning of the year	7,027	45,176
	-----	-----
End of period	\$ 5,669	\$ 30,924
	=====	=====

See notes to consolidated financial statements.

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Conn's , Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)
April 30, 2006
(Restated)

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 month period

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ended April 30, 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 are 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.

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Conn's, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

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 method. The following table sets forth the shares outstanding for the earnings per share calculations:

	Three Months Ended April 30,	
	2005	2006
Common stock outstanding, beginning of period	23,267,596	23,571,564
Weighted average common stock issued in stock option exercises	38,893	24,095

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Weighted average common stock issued to employee stock purchase plan	985	722
	-----	-----
Shares used in computing basic earnings per share	23,307,474	23,596,381
Dilutive effect of stock options, net of assumed repurchase of treasury stock	548,093	851,192
	-----	-----
Shares used in computing diluted earnings per share	23,855,567	24,447,573
	=====	=====

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 April 30, 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:

- o For the three months ended April 30, 2005 and 2006, Income before income taxes was reduced by \$262.7 thousand and \$393.1 thousand, respectively.
- o For the three months ended April 30, 2005 and 2006, Net income was reduced by \$220.3 thousand and \$323.9 thousand, respectively.
- o For the three months ended April 30, 2005 and 2006, Basic earnings per share was reduced by \$.01 and \$.01, respectively.
- o For the three months ended April 30, 2005 and 2006, Diluted earnings per share was reduced by \$.01 and \$.01, respectively.
- o For the three months ended April 30, 2005 and 2006, Cash flows from operating activities were reduced by, and Cash flows from investing activities were increased by, \$0.0 and \$133.3 thousand, respectively.
- o As of January 31, 2006, the Current deferred income tax asset increased \$301.1 thousand, 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 April 30, 2005 and 2006 would have decreased by 1.1% 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):

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Conn's, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

	Three Months Ended April 30,	
	2005	2006
Net income available for common stockholders as reported	\$ 9,868	\$ 11,949
Add: Stock-based compensation recorded, net of tax	220	324
Less: Stock-based compensation, net of tax for all awards	(324)	(372)
Pro forma net income	\$ 9,764	\$ 11,901
Earnings per share-as reported:		
Basic	\$ 0.42	\$ 0.51
Diluted	\$ 0.42	\$ 0.49
Pro forma earnings per share:		
Basic	\$ 0.42	\$ 0.50
Diluted	\$ 0.41	\$ 0.49

As of April 30, 2006, the total compensation cost related to non-vested awards not yet recognized totaled \$5.5 million and is expected to be recognized over a weighted average period of 3.6 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 April 30, 2005 and 2006, Product sales were reduced by \$595,000 and \$947,000, respectively, and Finance charges and other was increased by \$484,000 and \$730,000, respectively, to effect the adjustment to fair value and to reflect the appropriate amortization of the discount.

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.

Reclassifications. Certain reclassifications have been made in the prior year's financial statements to conform to current year's presentation.

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Specifically, 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.

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Conn's, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

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 months ended April 30, 2005 and 2006 (in thousands):

	Three Months Ended April 30,	
	2005	2006
Securitization income	\$ 13,305	\$ 15,237
Income from receivables not sold	280	335
Insurance commissions	4,155	4,266
Other	1,245	645
	-----	-----
Finance charges and other	\$ 18,985	\$ 20,483
	=====	=====

The components of total comprehensive income for the three months ended April 30, 2005 and 2006 are presented in the table below (in thousands):

	Three Months Ended April 30,	
	2005	2006
Net income	\$ 9,868	\$ 11,949
Unrealized gain on derivative instruments	246	-
Taxes on unrealized gain on derivatives	(86)	-
Adjustment of fair value of securitized assets	(1,409)	773
Taxes on adjustment of fair value	494	(264)
	-----	-----
Total comprehensive income	\$ 9,113	\$ 12,458
	=====	=====

3. Supplemental Disclosure Regarding Managed Receivables

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

Total Principal Amount of Receivables	Principal Amount 60 Days or More Past Due(1)
-----	-----
January 31, April 30,	January 31, April 30,

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	2006	2006	2006	2006
	-----	-----	-----	-----
Primary portfolio:				
Installment	\$ 380,603	\$ 367,774	\$ 24,934	\$ 21,914
Revolving	41,046	43,677	1,095	1,178
	-----	-----	-----	-----
Subtotal	421,649	411,451	26,029	23,092
Secondary portfolio:				
Installment	98,072	110,081	9,508	7,798
	-----	-----	-----	-----
Total receivables managed	519,721	521,532	35,537	30,890
Less receivables sold	509,681	510,944	33,483	29,076
	-----	-----	-----	-----
Receivables not sold	10,040	10,588	\$ 2,054	\$ 1,814
			=====	=====
Non-customer receivables	13,502	16,294		
	-----	-----		
Total accounts receivable, net	\$ 23,542	\$ 26,882		
	=====	=====		

(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.

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

	Average Balances		Credit Charge-offs	
	-----		-----	
	Three Months Ended April 30,		Three Months Ended April 30, (1)	
	-----	-----	-----	-----
	2005	2006	2005	2006
	-----	-----	-----	-----
Primary portfolio:				
Installment	\$ 331,285	\$ 373,072		
Revolving	30,452	42,553		
	-----	-----		
Subtotal	361,737	415,625	\$ 2,570	\$ 3,650
Secondary portfolio:				
Installment	74,823	104,610	408	1,028
	-----	-----	-----	-----
Total receivables managed	436,560	520,235	2,978	4,678
Less receivables sold	427,129	509,809	2,731	4,525
	-----	-----	-----	-----
Receivables not sold	\$ 9,431	\$ 10,426	\$ 247	\$ 153
	=====	=====	=====	=====

(1) Amounts represent total loan charge-offs, net of recoveries, on total receivables.

4. Fair Value of Derivatives

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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. During the three months ended April 30, 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 April 30, 2006, the Company had \$48.0 million of its \$50 million revolving credit facility available for borrowings. The amounts utilized under the revolving credit facility reflected \$2.0 million related to letters of credit issued. The letters of credit were issued under a \$5.0 million sublimit provided under the facility for standby letters of credit. 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 May 2006 and has a floating rate of interest, based on Prime, which equaled 7.25% at April 30, 2006. The Company anticipates that it will renew this facility, with a new maturity date one year from the current maturity.

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Conn's, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

The Company utilizes unsecured letters of credit to secure a portion of the QSPE's asset-backed securitization program, deductibles under the Company's insurance programs and international product purchases. At January 31, 2006 and April 30, 2006, the Company had outstanding unsecured letters of credit of \$13.0 million and \$12.3 million, respectively. These letters of credit were issued under the three following facilities:

- o The Company has a \$5.0 million sublimit provided under its revolving line of credit for stand-by and import letters of credit. At April 30, 2006, \$2.0 million of letters of credit were outstanding and callable at the option of the Company's insurance carrier if the Company does not honor its requirement to fund deductible amounts as billed under its insurance program.
- o The Company has arranged for a \$10.0 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 2006.
- o The Company obtained a \$1.5 million commitment for trade letters of

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credit to secure product purchases under an international arrangement. At April 30, 2006, there was \$269,000 outstanding under this commitment. The letter of credit commitment has a term of one year and expires in May 2006. The Company currently anticipates renewing this commitment.

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 \$16.5 million as of April 30, 2006.

6. Stock-Based Compensation

The Company 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. 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 April 30, 2006, the Company had 20,000 options remaining in 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 three month periods ended April 30, 2005 and 2006, the Company issued 2,829 and 2,073 shares of common stock, respectively, to employees participating in the plan, leaving 1,245,852 shares remaining reserved for future issuance under the plan as of April 30, 2006.

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Conn's, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

A summary of the status of the Company's Incentive Stock Option Plan and the activity during the three months ended April 30, 2005 and 2006 is presented below (shares in thousands):

	Three Months Ended April 30		
	2005		2006
	Shares	Weighted Average Exercise Price	Shares
Outstanding, beginning of period	1,666	\$ 11.50	1,626

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Granted	-	-	-
Exercised	(81) \$	(8.85)	(85)
Forfeited	(19) \$	(12.36)	(1)
	-----		-----
Outstanding, end of period	1,566 \$	11.62	1,540
	=====		=====
Options exercisable at end of period	631		659
Options available for grant	703		454
Intrinsic value of options exercised during the period	\$0.7 million		\$2.2 million

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Shares Outstanding April 30, 2006	Weighted Average Remaining Contractual Life in Years	Weighted Average Exercise Price	Shares Exercisable April 30, 2006	Weighted Average Exercise Price
\$4.29-\$4.29	9	3.7	\$ 4.29	9	\$ 4.29
\$8.21-\$10.83	630	5.1	\$ 8.55	504	\$ 8.40
\$14.00-\$16.49	294	7.7	\$ 14.32	97	\$ 14.13
\$17.73-\$17.73	280	8.6	\$ 17.73	49	\$ 17.73
\$33.88-\$33.88	327	9.6	\$ 33.88	-	\$ -
	-----		-----	-----	-----
Total	1,540	7.2	\$ 16.67	659	\$ 9.88
	=====		=====	=====	=====

Aggregate intrinsic value of exercisable options at April 30, 2006 \$16.0 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 effect 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 April 30, 2006, and are included on the face of the balance sheet in Deferred revenues and allowances.

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Conn's, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

8. Subsequent Events

Stock Option Plan Amendments. At the Company's annual shareholder's meeting on May 31, 2006, the shareholders approved an amendment to the Amended and Restated 2003 Incentive Stock Option Plan to increase the number of shares of common stock that may be issued under the plan from 2,559,767 to 3,859,767. If this amendment had taken place on April 30, 2006, there would have been 1,754,129 shares available for issuance under this plan as of April 30, 2006.

At the annual shareholder's meeting, the shareholders also approved an amendment to the 2003 Non-Employee Directors Stock Option Plan to increase the number of shares of common stock that may be issued under the plan from 300,000 to 600,000. If this amendment had taken place on April 30, 2006, there would have been 320,000 shares available for issuance under this plan as of April 30, 2006.

Texas Tax Law Changes. 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 the Company, as franchise taxes paid have totaled less than \$50,000 per year for the last several years. Partially offsetting this increase is a reduction in property tax rates that will be phased in during the 2006 and 2007 property tax years.

The tax changes will impact reported earnings beginning during the second quarter of the current fiscal year. The Company is currently analyzing the impact these changes will have on its financial condition and results of operations.

9. Restatement of Financial Statements

The Company has restated its consolidated financial statements for the quarters ended April 30, 2006, and 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.

In addition to the restatement adjustments discussed above, as a result of the review, the Company also refined certain of the assumptions used in the valuation of its interests in securitized assets at fair value. While these refinements did not result in a change in total securitization income reported, it did impact the amounts reported for the components of securitization income in the footnotes to the annual financial statements. Additionally, the changes resulted in an increase in the total fair value of the interests in securitized assets reflected on the balance sheet and a related increase in accumulated other comprehensive income, net of tax.

The information contained in the financial statements and notes thereto reflect the adjustments described herein and the modified retrospective application transition of the adoption of SFAS No. 123R (see Note 1) and does not reflect events occurring after June 1, 2006, the date of the original filing

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of our Quarterly Report on Form 10-Q for the quarter ended April 30, 2006, or modify or update those disclosures that have been affected by subsequent events.

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Conn's, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued

The following table sets forth the effects of the adjustments on Net Income for the quarters ended April 30, 2005 and 2006.

Increase in Net Income

(Dollars in thousands)	Quarters ended April 30,	
	2005	2006
As Previously Reported net income	\$ 9,582	\$ 11,378
Securitization income	387	1,100
Selling, general and administrative expense	-	(220)
Provision for bad debts	53	-
Income tax provision	(154)	(309)
Total adjustment	286	571
Restated net income	\$ 9,868	\$ 11,949
Percent change	3.0%	5.0%

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 quarters ended April 30, 2005 and 2006, Consolidated Balance Sheets as of January 31, 2006 and April 30, 2006, and Consolidated Statements of Cash Flows for the quarters ended April 30, 2005 and 2006.

Conn's, Inc.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share data)

	Quarters ended April 30,			
	2005		2006	
	As Previously Reported	Restated	As Previously Reported	Restated
Finance charges and other	\$ 19,229	\$ 18,985	\$ 20,410	\$ 20,483
Total revenues	158,163	157,919	192,115	192,188
Provision for bad debts	1,152	468	1,070	43
Total cost and expenses	142,039	142,349	174,808	174,001
Operating income	15,124	15,570	17,307	18,187
Income before income taxes	14,769	15,209	17,524	18,404
Total provision for income taxes	5,187	5,341	6,146	6,455
Net Income	9,582	9,868	11,378	11,949
Earnings per share				

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Basic	\$	0.41	\$	0.42	\$	0.48	\$	0.51
Diluted	\$	0.40	\$	0.42	\$	0.47	\$	0.49

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

Conn's, Inc.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	January 31, 2006		April 30, 2006	
	As Previously Reported	Restated	As Previously Reported	Restated
Interests in securitized assets	\$ 123,449	\$ 139,282	\$ 122,056	\$ 139,022
Deferred income taxes	4,971	-	3,518	-
Total current assets	275,129	285,991	268,417	281,865
Total assets	342,296	353,158	340,011	353,459
Accrued expenses	17,380	17,380	16,842	17,062
Income taxes payable	8,794	8,794	5,679	5,602
Deferred income taxes	757	1,343	906	3,334
Total current liabilities	95,332	95,918	79,649	82,220
Accumulated other comprehensive income	8,004	10,492	8,483	11,001
Retained earnings	148,318	156,106	159,696	168,055
Total stockholders' equity	245,585	255,861	258,967	269,844
Total liabilities and stockholders' equity	\$ 342,296	\$ 353,158	\$ 340,011	\$ 353,459

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

	Quarters Ended April 30,			
	2005		2006	
	As Previously Reported	Restated	As Previously Reported	Restated
Cash flows from operating activities				
Net income	\$ 9,582	\$ 9,868	\$ 11,378	\$ 11,944
Adjustments to reconcile net income to net cash provided by operating activities:				
Provision for bad debts	1,152	521	1,070	4,000
Accretion from interests in securitized assets	(3,606)	(4,897)	(3,407)	(5,130)
Provision for deferred income taxes	(2,355)	(2,202)	983	1,360
Change in operating assets and liabilities:				

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Accounts receivable	1,894	3,376	912	2,56
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In addition, the restatement also resulted in changes to the Consolidated Statements of Stockholders' Equity and Notes 1, 2 and 3.

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

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:

- o 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;
- o our intention to update or expand existing stores;
- o 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;
- o our cash flows from operations, borrowings from our revolving line of credit and proceeds from securitizations to fund our operations, debt repayment and expansion;
- o the ability of the QSPE to obtain additional funding for the purpose of purchasing our receivables;
- o rising interest rates may increase our cost of borrowing or reduce securitization income;
- o 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;
- o 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;
- o technological and market developments, growth trends and projected sales in the home appliance and consumer electronics industry, including with respect to digital products like DVD players, HDTV, digital audio, home networking devices and other new products, and our ability to capitalize on such growth;

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- o the potential for price erosion or lower unit sales points that could result in declines in revenues;
- o increasing 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;
- o 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;
- o 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;
- o our relationships with key suppliers;

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- o the adequacy of our distribution and information systems and management experience to support our expansion plans;
- o the accuracy of our expectations regarding competition and our competitive advantages;
- o the potential for market share erosion that could result in reduced revenues;
- o the accuracy of our expectations regarding the similarity or dissimilarity of our existing markets as compared to new markets we enter; and
- o 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 filed with the Securities Exchange Commission on March 30, 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 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

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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 9 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, VCRs, 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

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sales associates to be knowledgeable of all of our products, but to specialize in certain specific product categories.

We currently operate 58 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

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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 somewhat seasonal, with a greater portion of our revenues, pretax and net income realized during the quarter ending January 31, due to the holiday selling season, the major collegiate bowl season and the National Football League playoffs and Super Bowl.

Executive Overview

This narrative is intended to provide an executive level overview of our operations for the three months ended April 30, 2006. A detailed explanation of the changes in our operations for these periods as compared to the prior year is included in Results of Operations. As explained in that section, our pretax income for the quarter ended April 30, 2006 increased approximately 21.0%, primarily as a result of higher revenues and gross margin dollars, lower selling, general and administrative expenses as a percentage of revenues and lower interest (income) expense. Some of the more specific issues that impacted our operating and pretax income are:

- o Same store sales for the quarter grew 16.1% over the same period for the prior year. The improvement in same store sales growth was due primarily to improved execution at the store level and effective sales promotions. While we do not have sufficient information to determine what long-term impact Hurricanes Rita and Katrina will have on sales in the impacted markets, excluding the Southeast Texas and Louisiana markets, the same store sales increase was 11.6% in the other markets we serve. These other markets accounted for 78.7% of same store Product sales and Service maintenance agreement commissions during the three months ended April 30, 2006. It is our strategy to continue emphasizing our primary product categories and focusing on specialty product categories throughout the balance of fiscal 2007.
- o 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. Approximately \$11.7 million of our product sales increase for the quarter ended April 30, 2006 resulted from the opening of new stores in these markets. 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.
- o While deferred interest and "same as cash" plans continue to be an important part of our sales promotion plans, our improved execution and effective use of a variety of sales promotions, enabled us to reduce the

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level of deferred interest and "same as cash" plans. For the three months ended April 30, 2006, \$35.4 million, or 22.3%, in gross product sales were financed by deferred interest and "same as cash" plans. For the comparable period in the prior year gross product sales financed by deferred interest and "same as cash" sales were \$40.7 million, or 32.0%. We expect to continue to offer this type of extended term promotional credit in the future.

- o Our gross margin for the quarter decreased from 35.3% to 33.8% for the three months ended April 30, 2006 when compared to the same period in the prior year. This occurred primarily as a result of a change in our revenue

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mix as Product sales, which yielded a 20.7% gross margin in both periods, grew faster than higher margin Service revenues and Finance charges and other.

- o Finance charges and other grew 7.9%, which is a slower pace than Product sales as:
 - o service maintenance agreement retrospective commissions decreased \$0.7 million, due to a change in the commission structure resulting in higher front-end commissions, which are included in Net sales,
 - o insurance commission growth of 2.7% was impacted by reduced insurance sales penetration, and
 - o securitization income growth of 14.5% was impacted by a 65.7% increase in net credit losses due to higher than expected losses primarily as a result of the impact of Hurricane Rita on our credit operations. We recorded a portion of the losses against the special reserves which were provided in the quarter ended October 31, 2005. As of April 30, 2006, \$0.3 million remains in the special reserve for our estimate of the remaining expected losses caused by the impact of Hurricane Rita.
- o Operating margin also decreased from 9.9% to 9.5% for the three months ended April 30, 2006 when compared to the same period in the prior year due to reduced gross margin that was partially offset by our ability to reduce Selling, general and administrative (SG&A) expenses as a percent of revenues. During the three months ended April 30, 2006, we decreased SG&A expense as a percent of revenues to 24.3% from 25.1% when compared to the prior year, primarily from decreases in payroll and payroll related expenses and net advertising expense as a percent of revenues.
- o 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 April 30, 2006 as compared to \$0.3 million being recorded in the quarter ended April 30, 2005.

Operational Changes and Resulting Outlook

During the quarter, we opened a new store in Baytown, Texas. Additionally, we opened another new store in the Houston market during May 2006. 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. We also continue to look at other markets, including neighboring states for opportunities.

Our credit portfolio delinquency and charge-off statistics were negatively impacted by the effects of the hurricanes that hit the Gulf Coast during August and September of 2005, and the bankruptcy law change in October 2005. Non-storm factors that may have affected delinquencies and charge-offs include the impact of higher gasoline prices or higher interest rates on our customers and our internal collection efforts. However, as predicted, the delinquency performance of the credit portfolio continues to improve and is currently performing within the range of our historical results during the past four years. See detail information regarding the delinquency status of the credit portfolio in Note 3 to the financial statements.

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. Partially offsetting this increase is a reduction in property tax

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rates that will be phased in during the 2006 and 2007 property tax years. The

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tax changes will impact reported earnings beginning during the second quarter of the current fiscal year. We are currently analyzing the impact these changes will have on our financial condition and results of operations.

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 April 30, 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 \$5.6 million as of April 30, 2006, which may have an adverse effect

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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 were changed by 0.5% from 3.0% to 3.5%, the impact to recorded Finance charges and other would have been a reduction in revenues and pretax income of \$2.1 million.

Deferred Taxes. We have net deferred tax liabilities (approximately \$1.4 million as of April, 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 liability and decreased net income by approximately \$20,000.

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

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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 April 30, 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 April 30, 2006 and January 31, 2006 was \$3.9 million and \$3.6 million, respectively, and is included in Deferred revenues and allowances in

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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

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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:

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	Three Months Ended April 30,	
	2005	2006
Revenues:		
Product sales	80.6 %	82.5 %
Service maintenance agreement commissions (net)	4.4	4.1
Service revenues	3.0	2.7
	-----	-----
Total net sales	88.0	89.3
Finance charges and other	12.0	10.7
	-----	-----
Total revenues	100.0	100.0
Costs and expenses:		
Cost of goods sold, including warehousing and occupancy cost	63.9	65.4
Cost of parts sold, including warehousing and occupancy cost	0.8	0.8
Selling, general and administrative expense	25.1	24.3
Provision for bad debts	0.3	0.0
	-----	-----
Total costs and expenses	90.1	90.5
	-----	-----
Operating income	9.9	9.5
Interest (income) expense, net	0.3	(0.1)
Other (income) expense, net	0.0	0.0
	-----	-----
Income before income taxes	9.6	9.6
Provision for income taxes	3.4	3.4
	-----	-----
Net income	6.2 %	6.2 %
	=====	=====

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.

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Revenues. Total revenues increased by \$34.3 million, or 21.7%, from \$157.9 million for the three months ended April 30, 2005 to \$192.2 million for the three months ended April 30, 2006. The increase was attributable to increases in net sales of \$32.8 million, or 23.6%, and \$1.5 million, or 7.9%, in finance charges and other revenue.

The \$32.8 million increase in net sales was made up of the following:

- o a \$21.8 million same store sales increase of 16.1%. While we do not have sufficient information to determine what long-term impact Hurricanes Rita and Katrina will have on sales in the impacted markets, excluding the Southeast Texas and Louisiana markets, the same store sales increase was 11.6% in the other markets we serve. These other markets accounted for 78.7% of same store Product sales and Service maintenance agreement commissions during the three months ended April 30, 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 \$650,000, (offsetting this increase is a decrease in retrospective commissions which is reflected in Finance charges and other);
- o a \$10.9 million increase generated by seven retail locations that were not open for three consecutive months in each period;
- o a \$352,000 decrease resulted from an increase in discounts on extended-term promotional credit sales (those with terms longer than 12 months); and
- o a \$454,000 increase resulted from an increase in service revenues.

The components of the \$32.8 million increase in net sales, were a \$31.2 million increase in product sales and a \$1.6 million net increase in service maintenance agreement commissions and service revenues. The \$31.2 million increase in product sales resulted from the following:

- o approximately \$18.2 million was attributable to increases in unit sales, due to increased appliances, consumer electronics, and furniture sales, and
- o approximately \$13.0 million was attributable to increases in unit price points. The price point impact was driven by consumers selecting higher priced appliance products, including high-efficiency washers and dryers and stainless kitchen appliances.

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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.

Category	Three Months Ended April,				Percent Increase
	2005		2006		
	Amount	Percent	Amount	Percent	

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Major home appliances	\$ 46,601	33.4 %	\$ 61,864	36.0 %	32.8 % (1)
Consumer electronics	43,654	31.4	53,636	31.2	22.9 (2)
Track	22,741	16.4	23,206	13.5	2.0 (3)
Delivery	2,023	1.5	2,872	1.7	42.0 (4)
Lawn and garden	5,283	3.8	5,116	3.0	(3.2) (5)
Mattresses	2,907	2.1	5,096	3.0	75.3 (6)
Furniture	2,996	2.2	5,405	3.2	80.4 (7)
Other	1,070	0.8	1,314	0.8	22.8 (2)
<hr/>					
Total product sales	127,275	91.6	158,509	92.4	24.5
Service maintenance agreement commissions	6,884	5.0	7,967	4.6	15.7
Service revenues	4,775	3.4	5,229	3.0	9.5
<hr/>					
Total net sales	\$ 138,934	100.0 %	\$ 171,705	100.0 %	23.6 %
<hr/>					

- (1) In addition to strong overall sales growth, appliance sales benefited from increases in unit price points driven by consumers selecting higher priced appliance products, including high-efficiency washers and dryers and stainless kitchen appliances.
- (2) These increases are consistent with overall increase in product sales and improved unit prices.
- (3) The smaller level of track sales (consisting largely of computers, computer peripherals, portable electronics and small appliances) growth is due primarily to reduced unit prices and reduced sales of computers.
- (4) This increase is due primarily to the increase in total product sales as well as an increase in the fees charged for deliveries.
- (5) A delayed selling season due to dry weather contributed to this decrease.
- (6) This increase is due to increased emphasis on bedding and improved 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.

Revenue from Finance charges and other increased by approximately \$1.5 million, or 7.9%, from \$19.0 million for the three months ended April 30, 2005 to \$20.5 million for the three months ended April 30, 2006. It grew at a slower pace than the 24.5% increase in product sales due primarily to a \$0.7 million decrease in service maintenance agreement retrospective commissions, an increase in insurance commissions of 2.7% and an increase in securitization income of \$1.9 million, or 14.5%. Securitization income was impacted primarily by a 65.7% increase in net credit losses in the quarter ended April 30, 2006 as compared to the quarter ended April 30, 2005. The increased net credit losses were due to higher than expected losses primarily as a result of the impact of Hurricane Rita on our credit operations. We recorded a portion of the losses against the special reserves that were provided in the quarter ended October 31, 2005. As of April 30, 2006, \$0.3 million remains in the special reserves for our estimate of the remaining expected losses caused by the impact of Hurricane Rita. The securitization income increases are attributable to higher product sales and increases in our retained interest in assets transferred to the QSPE, due primarily to increases in the transferred balances.

Cost of Goods Sold. Cost of goods sold, including warehousing and occupancy cost, increased by \$24.8 million, or 24.6%, from \$100.9 million for the three

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months ended April 30, 2005 to \$125.7 million for the three months ended April 30, 2006. This increase was generally consistent with the 24.5% increase in net product sales during the three months ended April 30, 2006. Cost of products sold was 79.3% of net product sales in the quarter ended April 30, 2006 and 79.3% in the quarter ended April 30, 2005.

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Cost of Parts Sold. Cost of parts sold, including warehousing and occupancy cost, increased approximately \$340,000, or 27.8%, for the three months ended April 30, 2006 as compared to the three months ended April 30, 2005, due to increases in parts sales. While service revenues increased by 9.5% in the quarter ended April 30, 2006 as compared to the quarter ended April 30, 2005, the cost of parts sold increased at a faster rate due to reduced margins on parts sold through our service maintenance agreement program.

Selling, General and Administrative Expense. While Selling, general and administrative expense increased by \$6.9 million, or 17.4%, from \$39.7 million for the three months ended April 30, 2005 to \$46.6 million for the three months ended April 30, 2006, it decreased as a percentage of total revenue from 25.1% to 24.3%. The decrease in expense as a percentage of total revenues resulted primarily from decreased payroll and payroll related expenses and net advertising expense, as a percent of revenues. 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 April 30, 2006 as compared to \$0.3 million being recorded in the quarter ended April 30, 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 decreased by \$425,000, or 90.8%, during the three months ended April 30, 2006 as compared to the three months ended April 30, 2005, primarily as a result of changes in the loss history and provision adjustments, based on favorable loss experience during the last twelve months. See Note 3 to the financial statements for information regarding the performance of the credit portfolio.

Interest (Income) Expense, net. Net interest (income) expense decreased by \$539,000, or 151.8%, from net interest expense of \$355,000 for the three months ended April 30, 2005 to net interest income of \$184,000 for the three months ended April 30, 2006. The net decrease in interest expense was attributable to the following factors:

- o expiration of \$20.0 million in our interest rate hedges and the discontinuation of hedge accounting for derivatives resulted in a net decrease in interest expense of approximately \$244,000; and
- o increase in interest income from invested funds of approximately \$213,000;

The remaining decrease in interest expense of \$82,000 resulted from lower average outstanding debt balances and capitalization of interest expense on construction in progress.

Provision for Income Taxes. The provision for income taxes increased by \$1.1 million, or 20.8%, from \$5.3 million for the three months ended April 30, 2005 to \$6.4 million for the three months ended April 30, 2006, consistent with the increase in pretax income of 21.0%. Due to the implementation of SFAS 123R, we expect our effective tax rate to increase to between 35.5% and 36.0%.

Net Income. As a result of the above factors, Net income increased \$2.0

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million, or 21.1%, from \$9.9 million for the three months ended April 30, 2005 to \$11.9 million for the three months ended April 30, 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 April 30, 2006, we had approximately \$22.2 million in excess cash, the majority of which was generated through the operations of the Company. In addition to the excess cash, we had \$48.0 million under the 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,

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\$18.5 million under extended vendor terms for purchases of inventory and \$61.0 million in commitments available for the transfer of receivables to our QSPE.

A summary of the significant financial covenants that govern our bank credit facility compared to our actual D][GRAPHIC OMITTED][GRAPHIC OMITTED] compliance status at April 30, 2006, is presented below:

	Actual	Requi Minim Maxim
	-----	-----
Debt service coverage ratio must exceed required minimum	4.50 to 1.00	2.00 to
Total adjusted leverage ratio must be lower than required maximum	1.45 to 1.00	3.00 to
Consolidated net worth must exceed required minimum	\$258.8 million	\$154.8 m
Charge-off ratio must be lower than required maximum	0.03 to 1.00	0.06 to
Extension ratio must be lower than required maximum	0.02 to 1.00	0.05 to
Thirty-day delinquency ratio must be lower than required maximum	0.08 to 1.00	0.13 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 and capital programs through at least January 31, 2007. However, there are several factors that could decrease cash provided by operating activities, including:

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- o reduced demand for our products;
- o more stringent vendor terms on our inventory purchases;
- o loss of ability to acquire inventory on consignment;
- o increases in product cost that we may not be able to pass on to our customers;
- o reductions in product pricing due to competitor promotional activities;
- o changes in inventory requirements based on longer delivery times of the manufacturers or other requirements which would negatively impact our delivery and distribution capabilities;
- o 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);
- o 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;
- o increases in program costs (interest and administrative fees relative to our receivables portfolio associated with the funding of our receivables); and
- o increases in personnel costs required for us to stay competitive in our markets.

During the three months ended April 30, 2006, net cash provided by operating activities decreased \$20.1 million from \$11.7 million provided in the 2005 period to \$8.4 million used in the 2006 period. The net decrease in cash provided from operations resulted primarily from the timing of payments of

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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 quarter ended April 30, 2006 and we were required to satisfy those obligations, which negatively impacted our operating cash flows by approximately \$18.9 million.

As noted above, we offer promotional credit programs to certain customers that provide for "same as cash" interest free periods of varying terms, generally three, six, or 12 months; in fiscal year 2005 we increased these terms to include 18 or 24 months that are eligible to be partially funded through our asset-backed securitization program. In the second quarter of fiscal 2005, we began offering deferred interest programs with 36-month terms. In the second quarter of fiscal 2006, we began offering deferred interest programs with 24-month terms. The three, six, 12, 18, 24 and 36 month "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

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period. The percentage of eligible securitized receivables represented by promotional receivables was 17.9% as of April 30, 2006. At April 30, 2005, this percentage, computed on a consistent basis with the April 30, 2006 calculation, would have been 24.1%. The weighted average promotional period was 12.6 months and 11.7 months for promotional receivables outstanding as of April 30, 2005 and 2006, respectively. The weighted average remaining term on those same promotional receivables was 8.7 months and 7.3 months, respectively. While overall these promotional receivables have a much shorter weighted average term than non-promotional receivables, we receive less income as a result of a reduced net interest margin used in the calculation of the gain on the sale of receivables. As a result, the existence of the interest free extended payment terms negatively impacts the gains as compared to other receivables.

Net cash used by investing activities increased by \$3.7 million, from \$3.3 million for the three months ended April 30, 2005 to \$7.0 million for the three months ended April 30, 2006. The increase in cash used in investing activities resulted primarily from an increase of \$3.7 million for 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, as compared to fiscal 2006.

Net cash from financing activities increased by \$10.9 million from \$9.8 million used during the three months ended April 30, 2005 to \$1.1 million provided during the three months ended April 30, 2006. The increase in cash provided by financing activities resulted primarily from decreases in payments on various debt instruments of \$10.4 million. Also benefiting cash flow from financing activities was increased proceeds from stock issued under employee benefit plans.

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 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.

At April 30, 2006, the issuer had issued two series of notes and bonds: a Series A variable funding note in the amount of \$250 million purchased by Three Pillars Funding LLC and three classes of Series B bonds in the aggregate amount of \$200 million, of which \$8.0 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 the Series B agreements, falls below 5.0%, then the issuer may be required to fund a cash reserve in addition to the \$8.0 million restricted cash account. At April 30, 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%. The issuer is

currently in the process of marketing an additional \$150 million dollars of fixed rate bonds, but no assurance can be given that a transaction can be completed on terms favorable to it. It is currently anticipated that the

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transaction will be completed in the second quarter of the current fiscal year. The proceeds of the new issuance will provide the issuer additional capacity for the purchase of our receivables. If the issuer is unable to complete the new bond issuance, then, after its current funding sources are exhausted, we may have to fund growth in the receivables portfolio until the issuer can obtain additional funding.

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 or the Series B bond holders, the servicing fee and additional earnings to the extent they are available.

The Series A variable funding note permits the issuer to borrow funds up to \$250 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 \$250 million, the issuer intends 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. As of April 30, 2006, borrowings under the Series A variable funding note were \$189.0 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 and Series B 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, and the Series B bond holders could claim the balance in its \$8.0 million restricted cash account. We are also contingently liable under a \$10.0 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 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 April 30, 2006, is presented below:

	As reported	Required Minimum/ Maximum
	-----	-----
Issuer interest must exceed required minimum	\$43.1 million	\$45.6 million
Gross loss rate must be lower than required maximum	4.4%	10.0%

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Net portfolio yield must exceed required minimum	8.1%	2.0%
Payment rate must exceed required minimum	7.1%	3.0%

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.

As indicated in the table above, the minimum issuer interest requirement was not satisfied as of April 30, 2006. The minimum issuer interest requirement is based on information that is not available until after the end of the month. Upon determining the new minimum issuer interest requirement, the Issuer deposited the amount necessary to satisfy the required minimum. This temporary

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deficiency does not in anyway limit the Issuer's ability to function, including funding the transfer of future receivables created by us. Additionally, it did not result in any unscheduled amortization requirements for either the Series A or Series B Notes.

Events of default under the Series A variable funding note and the Series B 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

			----->	Series A Note
			-	\$250 million
			-	Credit Rating: P1/A2
			-	Three Pillars Funding LLC
			-	
	Customer Receivables			
	----->	-----		
		Qualifying		
	Retail	Special Purpose		