

Edgar Filing: CONNS INC - Form 10-Q

CONNS INC
Form 10-Q
September 15, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended July 31, 2006

Commission File Number

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

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

06-167284
(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 September 13, 2006:

Class	Outstanding
Common stock, \$.01 par value per share	23,697,318

Edgar Filing: CONNS INC - Form 10-Q

TABLE OF CONTENTS

PART I.	FINANCIAL INFORMATION
Item 1.	Financial Statements.....
	Consolidated Balance Sheets as of January 31, 2006 and July 31, 2006.....
	Consolidated Statements of Operations for the three and six months ended July 31, 2005 and 2006.....
	Consolidated Statement of Stockholders' Equity for the six months ended July 31, 2006.....
	Consolidated Statements of Cash Flows for the six months ended July 31, 2005 and 2006.....
	Notes to Consolidated Financial Statements.....
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations.....
Item 3.	Quantitative and Qualitative Disclosures About Market Risk.....
Item 4.	Controls and Procedures.....
PART II.	OTHER INFORMATION
Item 1.	Legal Proceedings.....
Item 1A.	Risk Factors.....
Item 4.	Submission of Matters to a Vote of Security Holders.....
Item 5.	Other Information.....
Item 6.	Exhibits.....
SIGNATURE

i

Part I. FINANCIAL INFORMATION
Item 1. Financial Statements

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

January 31,
2006

July 31,
2006

Edgar Filing: CONNS INC - Form 10-Q

		(unaudited)
Assets		
Current assets		
Cash and cash equivalents	\$ 45,176	\$ 22,92
Accounts receivable, net	23,542	30,39
Interests in securitized assets	139,282	145,84
Inventories	73,987	79,64
Prepaid expenses and other assets	4,004	3,83
Total current assets	285,991	282,62
Non-current deferred income tax asset	2,464	3,28
Property and equipment		
Land	6,671	8,94
Buildings	7,084	9,87
Equipment and fixtures	9,612	11,96
Transportation equipment	3,284	2,96
Leasehold improvements	65,507	67,45
Subtotal	92,158	101,20
Less accumulated depreciation	(37,332)	(42,11)
Total property and equipment, net	54,826	59,08
Goodwill, net	9,617	9,61
Debt issuance costs and other assets, net	260	34
Total assets	\$ 353,158	\$ 354,95
Liabilities and Stockholders' Equity		
Current liabilities		
Current portion of long-term debt	\$ 136	\$ -
Accounts payable	40,920	37,47
Accrued compensation and related expenses	18,847	7,25
Accrued expenses	17,380	18,21
Income taxes payable	8,794	18
Deferred income taxes	1,343	2,86
Deferred revenues and allowances	8,498	9,04
Total current liabilities	95,918	75,03
Long-term debt	--	-
Non-current deferred income tax liability	903	1,03
Deferred gain on sale of property	476	39
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 23,697,318 shares issued and outstanding at January 31, 2006 and July 31, 2006, respectively)	236	23
Additional paid-in capital	89,027	91,29
Accumulated other comprehensive income	10,492	10,35
Retained earnings	156,106	176,59
Total stockholders' equity	255,861	278,49
Total liabilities and stockholders' equity	\$ 353,158	\$ 354,95

See notes to consolidated financial statements.

Edgar Filing: CONNS INC - Form 10-Q

1

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

	Three Months Ended July 31,		Six Months Ended July 31,
	2005	2006	2005
Revenues			
Product sales	\$ 130,867	\$ 150,647	\$ 258,142
Service maintenance agreement commissions, net	7,848	7,063	14,732
Service revenues	5,134	5,927	9,909
Total net sales	143,849	163,637	282,783
Finance charges and other	20,711	18,567	39,696
Total revenues	164,560	182,204	322,479
Cost and expenses			
Cost of goods sold, including warehousing and occupancy costs	103,579	119,756	204,496
Cost of parts sold, including warehousing and occupancy costs	1,236	1,389	2,461
Selling, general and administrative expense ...	44,950	48,425	84,689
Provision for bad debts	(137)	390	331
Total cost and expenses	149,628	169,960	291,977
Operating income	14,932	12,244	30,502
Interest (income) expense, net	59	(187)	414
Other (income) expense, net	28	(721)	34
Income before income taxes	14,845	13,152	30,054
Provision for income taxes			
Current	5,564	5,247	13,107
Deferred	(312)	(639)	(2,514)
Total provision for income taxes	5,252	4,608	10,593
Net income	\$ 9,593	\$ 8,544	\$ 19,461
	=====	=====	=====
Earnings per share			
Basic	\$ 0.41	\$ 0.36	\$ 0.83
Diluted	\$ 0.40	\$ 0.35	\$ 0.81
Average common shares outstanding			
Basic	23,366	23,676	23,337

Edgar Filing: CONNS INC - Form 10-Q

Diluted	24,012	24,344	23,896
---------------	--------	--------	--------

See notes to consolidated financial statements.

2

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

	Common Stock		Accum. Other Compre- hensive Income	Additional Paid-in Capital
	Shares	Amount		
Balance January 31, 2006.....	23,572	\$ 236	\$10,492	\$ 89,027
Exercise of options to acquire 120,928 shares of common stock.....	121	1		1,212
Issuance of 4,826 shares of common stock under Employee Stock Purchase Plan.....	4			123
Stock-based compensation.....				802
Tax benefit from options exercised.....				135
Net income.....				
Adjustment of fair value of securitized assets (including tax benefit of \$119), net of reclassification adjustments of \$6,572 (net of tax of \$3,697)			(135)	
Total comprehensive income.....				
Balance July 31, 2006.....	23,697	\$ 237	\$10,357	\$ 91,299

See notes to consolidated financial statements.

3

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

Edgar Filing: CONNS INC - Form 10-Q

	Six Mo J
	2005
Cash flows from operating activities	
Net income	\$ 19,461
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation	5,407
Amortization	(131)
Provision for bad debts	384
Stock-based compensation	541
Excess tax benefits from stock-based compensation	--
Discounts on promotional credit	536
Accretion from interests in securitized assets	(9,439)
Provision for deferred income taxes	(2,514)
Loss (Gain) from sale of property and equipment	34
Loss from derivatives	69
Changes in operating assets and liabilities:	
Accounts receivable	2,358
Inventory	1,500
Prepaid expenses and other assets	778
Accounts payable	6,598
Accrued expenses	4,713
Income taxes payable	--
Deferred revenue and allowances	1,101
Net cash provided by (used in) operating activities	31,396
Cash flows from investing activities	
Purchase of property and equipment	(9,964)
Proceeds from sales of property	13
Net cash used in investing activities	(9,951)
Cash flows from financing activities	
Proceeds from stock issued under employee benefit plans	1,091
Excess tax benefits from stock-based compensation	--
Borrowings under lines of credit	41,900
Payments on lines of credit	(52,400)
Increase in debt issuance costs	--
Payment of promissory notes	(14)
Net cash provided by (used in) financing activities	(9,423)
Net change in cash	12,022
Cash and cash equivalents	
Beginning of the year	7,027
End of period	\$ 19,049

See notes to consolidated financial statements.

Edgar Filing: CONNS INC - Form 10-Q

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

1. Summary of Significant Accounting Policies

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

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

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

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

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

Edgar Filing: CONNS INC - Form 10-Q

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 July 31,		
	2005	2006	2006
Common stock outstanding, beginning of period	23,351,044	23,665,335	23,260,000
Weighted average common stock issued in stock option exercises	13,699	9,852	6,000
Weighted average common stock issued to employee stock purchase plan	1,040	958	0
Shares used in computing basic earnings per share.....	23,365,783	23,676,145	23,330,000
Dilutive effect of stock options, net of assumed repurchase of treasury stock	646,522	667,915	550,000
Shares used in computing diluted earnings per share...	24,012,305	24,344,060	23,880,000

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 July 31, 2006 that no impairment of goodwill existed.

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

- o For the three months ended July 31, 2005 and 2006, Income before income taxes was reduced by \$0.3 million and \$0.4 million, respectively. For the six months ended July 31, 2005 and 2006, Income before income taxes was reduced by \$0.5 million and \$0.8 million, respectively.
- o For the three months ended July 31, 2005 and 2006, Net income was reduced by \$0.2 million and \$0.3 million, respectively. For the six months ended July 31, 2005 and 2006, Net income was reduced by \$0.4 million and \$0.7 million, respectively.
- o For the three months ended July 31, 2005 and 2006, Basic earnings per share was reduced by \$.01 and \$.01, respectively. For the six months ended July 31, 2005 and 2006, Basic earnings per share was reduced by \$.02 and \$.03, respectively.
- o For the three months ended July 31, 2005 and 2006, Diluted earnings per share was reduced by \$.01 and \$.01, respectively. For the six months ended July 31, 2005 and 2006, Diluted earnings per share was reduced by \$.02 and \$.03, respectively.

Edgar Filing: CONNS INC - Form 10-Q

- o For the six months ended July 31, 2005 and 2006, Cash flows from operating activities were reduced by, and Cash flows from investing activities were increased by, \$0.0 and \$0.1 million, respectively.
- o As of January 31, 2006, the Current deferred income tax asset increased \$0.3 million, Additional paid-in capital increased \$2.0 million and Retained earnings decreased \$1.7 million.

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

6

Conn's , Inc. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

available for common stockholders for the three months ended July 31, 2005 and 2006 would have decreased by 1.1% and 0.6%, respectively. Net income available for common stockholders for the six months ended July 31, 2005 and 2006 would have decreased by 1.1% and 0.5%, respectively. The following table presents the impact to earnings per share as if the Company had adopted the fair value recognition provisions of SFAS No. 123 (dollars in thousands except per share data):

	Three Months Ended July 31,		
	2005	2006	
Net income available for common stockholders as reported	\$ 9,593	\$ 8,544	\$
Add: Stock-based compensation recorded, net of tax	227	339	
Less: Stock-based compensation, net of tax for all awards	(330)	(387)	
Pro forma net income	\$ 9,490	\$ 8,496	\$
Earnings per share-as reported:			
Basic	\$ 0.41	\$ 0.36	\$
Diluted	\$ 0.40	\$ 0.35	\$
Pro forma earnings per share:			
Basic	\$ 0.41	\$ 0.36	\$
Diluted	\$ 0.40	\$ 0.35	\$

As of July 31, 2006, the total compensation cost related to non-vested awards not yet recognized totaled \$4.9 million and is expected to be recognized over a weighted average period of 3.5 years.

Edgar Filing: CONNS INC - Form 10-Q

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 July 31, 2005 and 2006, Product sales were reduced by \$1.0 million and \$0.7 million, respectively, and Finance charges and other was increased by \$0.6 million and \$0.8 million, respectively, to effect the adjustment to fair value and to reflect the appropriate amortization of the discount. For the six months ended July 31, 2005 and 2006, Product sales were reduced by \$1.6 million and \$1.6 million, respectively, and Finance charges and other was increased by \$1.1 million and \$1.5 million, respectively, to effect the adjustment to fair value and to reflect the appropriate amortization of the discount.

Texas Tax Law Changes. On May 18, 2006, the Governor of Texas signed a tax bill that modified the existing franchise tax, with the most significant change being the replacement of the existing base with a tax based on margin. Taxable margin is generally defined as total federal tax revenues minus the greater of (a) cost of goods sold or (b) compensation. The tax rate to be paid by retailers and wholesalers is 0.5% on taxable margin. This will result in an increase in taxes paid by the Company, as franchise taxes paid have totaled less than \$50,000 per year for the last several years. 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 impacted earnings beginning in this quarter. For the quarter and six months ended July 31, 2006, the Company accrued, net of federal tax benefit, \$118,000 in additional tax liability and recorded approximately \$29,000 in deferred tax assets as a result of the new margin tax.

7

Conn's , Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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. Specifically, Other (income) expense, which consists of (gain) loss on sales of property and equipment, is now separately detailed. Previously these amounts were included in Selling, general and administrative expense. Additionally, the impact of the cancellation of insurance policies on charged-off receivables, which were previously included in the Provision for bad debts on the consolidated statements of operations, are now reported as a reduction of

Edgar Filing: CONNS INC - Form 10-Q

Insurance commissions, which is included in Finance charges and other.

2. Supplemental Disclosure of Revenue and Comprehensive Income

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

	Three Months Ended July 31,		Six Months Ended July 31,
	2005	2006	2005
Securitization income (1)	\$ 14,994	\$ 13,274	\$28,299
Income from receivables not sold	304	323	584
Insurance commissions	4,227	4,729	8,382
Other	1,186	241	2,431
Finance charges and other	\$ 20,711	\$ 18,567	\$39,696

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

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

	Three Months Ended July 31,		Six Months Ended July 31,
	2005	2006	2005
Net income	\$ 9,593	\$ 8,544	\$19,461
Unrealized gain on derivative instruments	-	-	246
Taxes on unrealized gain on derivatives	-	-	(86)
Adjustment of fair value of securitized assets	2,443	(789)	1,034
Taxes on adjustment of fair value	(857)	145	(363)
Total comprehensive income	\$ 11,179	\$ 7,900	\$20,292

3. Supplemental Disclosure Regarding Managed Receivables

Edgar Filing: CONNS INC - Form 10-Q

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, 2006	July 31, 2006	January 31, 2006	July 31, 2006
Primary portfolio:				
Installment	\$380,603	\$369,611	\$ 24,934	\$ 20,127
Revolving	41,046	43,793	1,095	959
Subtotal	421,649	413,404	26,029	21,086
Secondary portfolio:				
Installment	98,072	117,268	9,508	9,693
Total receivables managed	519,721	530,672	35,537	30,779
Less receivables sold	509,681	520,256	33,483	29,263
Receivables not sold	10,040	10,416	\$ 2,054	\$ 1,516
Non-customer receivables	13,502	19,974		
Total accounts receivable, net	\$ 23,542	\$ 30,390		

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

	Average Balances		Credit Charge-offs (1)	
	Three Months Ended July 31,		Three Months Ended July 31,	
	2005	2006	2005	2006
Primary portfolio:				
Installment	\$ 344,728	\$ 368,939		
Revolving	33,237	43,541		
Subtotal	377,965	412,480	\$ 2,539	\$ 4,225
Secondary portfolio:				
Installment	80,632	113,821	444	830
Total receivables managed	458,597	526,301	2,983	5,055
Less receivables sold	449,081	515,865	2,801	4,874
Receivables not sold	\$ 9,516	\$ 10,436	\$ 182	\$ 181

Edgar Filing: CONNS INC - Form 10-Q

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

9

Conn's , Inc. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	Average Balances		Credit Charge-offs (1)	
	Six Months Ended July 31,		Six Months Ended July 31,	
	2005	2006	2005	2006
Primary portfolio:				
Installment	\$ 338,315	\$ 371,493		
Revolving	32,025	42,957		
Subtotal	370,340	414,450	\$ 5,110	\$ 7,87
Secondary portfolio:				
Installment	77,679	109,102	851	1,85
Total receivables managed	448,019	523,552	5,961	9,73
Less receivables sold	438,533	513,144	5,532	9,39
Receivables not sold	\$ 9,486	\$ 10,408	\$ 429	\$ 33

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

4. Fair Value of Derivatives

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

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

Edgar Filing: CONNS INC - Form 10-Q

5. Debt and Letters of Credit

At July 31, 2006, the Company had \$48.6 million of its \$50 million revolving credit facility available for borrowings. The amounts utilized under the revolving credit facility reflected \$1.4 million related to letters of credit issued. Additionally, there were no amounts outstanding under a short-term revolving bank agreement that provides up to \$8.0 million of availability on an unsecured basis. This unsecured facility matures in June 2007 and has a floating rate of interest, based on Prime, which equaled 7.75% at July 31, 2006.

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

10

Conn's , Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

- 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 July 31, 2006, \$1.4 million of letters of credit were outstanding and callable at the option of the Company's property and casualty insurance carrier if the Company does not honor its requirement to fund deductible amounts as billed under its insurance program.
- 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. The Company plans to renew this letter of credit and increase the amount to \$20.0 million in September, 2006.
- o The Company obtained a \$3.0 million commitment for trade letters of credit to secure product purchases under an international arrangement. At July 31, 2006, there was \$1.6 million outstanding under this commitment. The letter of credit commitment has a term of one year and expires in May 2007. No letter of credit issued under this commitment can have an expiration date more than 180 days after the commitment expiration date.

The maximum potential amount of future payments under these letter of credit facilities is considered to be the aggregate face amount of each letter of credit commitment, which total \$18.0 million as of July 31, 2006.

6. Stock-Based Compensation

The Company originally approved an Incentive Stock Option Plan that provides for a pool of up to 3.5 million options to purchase shares of the Company's common stock. Such options are to be granted to various officers and employees at prices equal to the market value on the date of the grant. The options vest over three or five year periods (depending on the grant) and expire ten years after the date of grant. As part of the completion of the IPO, the Company amended the Incentive Stock Option Plan to provide for a total available pool of 2,559,767 options, adopted a Non-Employee Director Stock Option Plan that included 300,000 options, and adopted an Employee Stock Purchase Plan that reserved up to 1,267,085 shares of the Company's common stock to be issued. At

Edgar Filing: CONNS INC - Form 10-Q

the Company's annual meeting on May 31, 2006, amendments to the stock option plans were approved, which increased the shares available under the Incentive Stock Option Plan to 3,859,767 and increased the shares available under the Non-Employee Director Stock Option Plan to 600,000. On November 24, 2003, the Company issued six non-employee directors 240,000 total options to acquire the Company's stock at \$14.00 per share. On June 3, 2004, the Company issued 40,000 options to acquire the Company's stock at \$17.34 per share to a seventh non-employee director. At July 31, 2006, the Company had 320,000 options available for grant under the Non-Employee Director Stock Option Plan.

The Employee Stock Purchase Plan is available to a majority of the employees of the Company and its subsidiaries, subject to minimum employment conditions and maximum compensation limitations. At the end of each calendar quarter, employee contributions are used to acquire shares of common stock at 85% of the lower of the fair market value of the common stock on the first or last day of the calendar quarter. During the six month periods ended July 31, 2005 and 2006, the Company issued 5,820 and 4,826 shares of common stock, respectively, to employees participating in the plan, leaving 1,243,099 shares remaining reserved for future issuance under the plan as of July 31, 2006.

11

Conn's , Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

	Six Months Ended	
	2005	
	Shares	Weighted Average Exercise Price
Outstanding, beginning of period	1,666	\$ 11.50
Granted	-	-
Exercised	(115)	\$ (8.79)
Forfeited	(41)	\$ (14.43)
Outstanding, end of period	1,510	\$ 11.62
Options exercisable at end of period	755	
Options available for grant	726	
Intrinsic value of options exercised during the period	\$1.2 million	\$

Options Outstanding		
Shares	Weighted Average	Weighted

Edgar Filing: CONNS INC - Form 10-Q

Range of Exercise Prices	Outstanding July 31, 2006	Remaining Contractual Life in Years	Average Exercise Price	
\$8.21-\$10.83	617	4.8	\$ 8.52	
\$14.00 -\$16.49	286	7.4	\$ 14.29	
\$17.73-\$17.73	276	8.3	\$ 17.73	
\$33.88-\$33.88	325	9.3	\$ 33.88	

Total	1,504	6.9	\$ 16.79	
	=====			
Aggregate intrinsic value of exercisable options				
at July 31, 2006	\$11.6 million			

7. Contingencies

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

Service Maintenance Agreement Obligations. The Company sells service maintenance agreements under which it is the obligor for payment of qualifying claims. The Company is responsible for administering the program, including setting the pricing of the agreements sold and paying the claims. The typical term for these agreements is between 12 and 36 months. The pricing is set based on historical claims experience and expectations about future claims. While the Company is unable to estimate maximum potential claim exposure, it has a history of overall profitability upon the ultimate resolution of agreements sold. The revenues related to the agreements sold are deferred at the time of sale and recorded in revenues in the statement of operations over the life of the agreements. The revenues deferred related to these agreements totaled \$3.6 million and \$3.7 million, respectively, as of January 31, 2006 and July 31, 2006, and are included on the face of the balance sheet in Deferred revenues and allowances.

12

Conn's , Inc. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

8. Restatement of Financial Statements

The Company has restated its consolidated financial statements for the quarter and six-monhts ended July 31, 2005 to correct for errors in recording interests in securitized assets, securitization income and related income tax impacts that were incorrectly accounted for under U.S. generally accepted accounting principles, specifically covered by Statement of Financial Accounting Standards ("SFAS") No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities and Emerging Issues Task Force ("EITF") No. 99-20, Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interest in Securitized Financial Assets.

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

Edgar Filing: CONNS INC - Form 10-Q

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

Increase in Net Income	Quarter ended July 31, 2005	Six Months ended July 31, 2005
(Dollars in thousands)	-----	-----
As Previously Reported net income	\$ 9,097	\$ 18,679
Securitization income	765	1,152
Provision for bad debts	--	53
Income tax provision	(269)	(423)
	-----	-----
Total adjustment	496	782
	-----	-----
Restated net income	\$ 9,593	\$ 19,461
	=====	=====
Percent change	5.5%	4.2%

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

13

Conn's , Inc. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

	Quarter ended		Six-Months ended	
	July 31, 2005		July 31, 2005	
	As Previously Reported	Restated	As Previously Reported	Restated
	-----	-----	-----	-----
Finance charges and other	\$ 20,526	\$ 20,711	\$ 39,755	\$ 39,6
Total revenues	164,375	164,560	322,538	322,4
Provision for bad debts	443	(137)	1,595	3
Total cost and expenses	150,236	149,628	293,241	291,9
Operating income	14,139	14,932	29,297	30,5
Income before income taxes	14,080	14,845	28,849	30,0
Total provision for income taxes	4,983	5,252	10,170	10,5
Net Income	9,097	9,593	18,679	19,4

Edgar Filing: CONNS INC - Form 10-Q

Earnings per share				
Basic	\$0.39	\$0.41	\$0.80	\$0.
Diluted	\$0.38	\$0.40	\$0.78	\$0.

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

	Six-Months ended	
	July 31, 2005	
	As Previously Reported	Restated
Cash flows from operating activities		
Net income	\$ 18,679	\$ 19,460
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for bad debts.....	1,595	384
Accretion from interests in securitized assets.....	(7,120)	(9,439)
Provision for deferred income taxes.....	(2,936)	(2,514)
Change in operating assets and liabilities:		
Accounts receivable.....	33	2,358

9. Subsequent Events

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

Financing Transaction Completed by QSPE. On August 31, 2006, the Company's QSPE closed and consummated an offering of \$150 million in medium term asset-backed fixed-rate notes. The proceeds of the offering were used by the QSPE to pay down the balance on its revolving credit facility.

Stock Repurchase Plan. On August 25, 2006, the Company announced the adoption of a stock repurchase program, approved by the Board of Directors, authorizing the repurchase of up to \$50 million of the Company's common stock.

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

Forward-Looking Statements

This report contains forward-looking statements. We sometimes use words

Edgar Filing: CONNS INC - Form 10-Q

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;
- 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;

Edgar Filing: CONNS INC - Form 10-Q

- o our relationships with key suppliers;

15

- 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/A filed with the Securities Exchange Commission on September 15, 2006. In light of these risks, uncertainties and assumptions, the forward-looking events and circumstances discussed in this report might not happen.

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

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

General

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

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

On February 1, 2006, we were required to adopt Statement of Financial

Edgar Filing: CONNS INC - Form 10-Q

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

16

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 credit losses due to death, disability, involuntary unemployment and property damage and product failure not covered by a manufacturers' warranty. We also derive revenues from the sale of extended service maintenance agreements, under which we are the primary obligor, to protect the customers after the original manufacturer's warranty or service maintenance agreement has expired.

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

Executive Overview

This narrative is intended to provide an executive level overview of our operations for the three and six months ended July 31, 2006. A detailed explanation of the changes in our operations for these periods as compared to the prior year is included under Results of Operations. As explained in that section, our pretax income for the quarter ended July 31, 2006 decreased approximately 11.4%, as the decrease in the gross margin percentage offset the

Edgar Filing: CONNS INC - Form 10-Q

benefit of increased revenues, lower selling, general and administrative expenses as a percentage of revenues, lower interest expense and higher other income. Our pretax income for the six months ended July 31, 2006 increased approximately 5.0%, primarily as a result of higher revenues and gross margin dollars, lower selling, general and administrative expenses as a percentage of revenues, lower interest expense and higher other income. Some of the more specific items impacting our operating and pretax income were:

- o Same store sales for the quarter grew 7.2% and for the six months same store sales grew 11.7% 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 3.8% for the quarter and 7.8% for the six months ended in the other markets we serve. These other markets accounted for 78.9% of same store Product sales and Service maintenance agreement commissions during the three months ended July 31, 2006 and 78.5% of same store Product sales and Service maintenance agreement commissions during the six months ended July 31, 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 \$8.7 million and \$19.4 million of our product sales and service maintenance agreement commissions increase for the quarter and six months ended July 31, 2006, respectively, 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.

17

- 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 level of deferred interest and "same as cash" plans. For the three months and six months ended July 31, 2006, \$35.7 million, or 23.7%, and \$71.1 million, or 23.0%, respectively, in gross product sales were financed by deferred interest and "same as cash" plans. For the comparable periods in the prior year gross product sales financed by deferred interest and "same as cash" sales were \$39.8 million, or 30.4% and \$80.5 million, or 31.2%. We expect to increase the use of this type of extended term promotional credit in the future.
- o Our gross margin for the quarter decreased from 36.3% to 33.5% for the three months ended July 31, 2006 when compared to the same period in the prior year, primarily as a result of the impact on securitization income of increased charge-offs in the credit portfolio (see Note 3 to the Consolidated Financial Statements), reduced front-end and retrospective Service Maintenance agreement commissions, due to a lower sales penetration during the period, and a reduction in the gross margin on product sales to 20.5% in the quarter ended July 31, 2006, from 20.9% in the prior year. Our gross margin for the six months decreased from 35.8% to 33.6% for the six months ended July 31, 2006 when compared to the same period in the prior year, primarily due to the impact on securitization income of higher charge-offs in the credit portfolio, reduced retrospective Service Maintenance agreement commissions and a reduction in

Edgar Filing: CONNS INC - Form 10-Q

the gross margin on product sales to 20.6% for the six months ended July 31, 2006, from 20.8% in the prior year.

- o Finance charges and other declined 10.4% for the quarter and 1.6% for the six months ended July 31, 2006, as compared to the double-digit growth in Product sales as:
 - o securitization income, which declined by 12.6% for the quarter and increased 0.1% for the six months ended July 31, 2006, was impacted by a 74.0% increase in net credit losses for the quarter and a 69.9% increase for the six months ended July 31, 2006, due to higher than expected losses primarily as a result of the disruption to our credit operations caused by Hurricane Rita. During the three months ended July 31, 2006, due to the expectation of continued higher losses over the next six months, we recorded an impairment charge of \$1.5 million, reducing the value of our interest in securitized assets.
 - o service maintenance agreement retrospective commissions for the quarter and the six months ended July 31, 2006 decreased \$0.9 million and \$1.6 million, respectively, due to a change in the commission structure resulting in higher front-end commissions, which are included in Net sales,
- o During the three months ended July 31, 2006, we decreased Selling, general and administrative (SG&A) expense as a percent of revenues to 26.6% from 27.3% when compared to the prior year, primarily from decreases in payroll and payroll related expenses and net advertising expense as a percent of revenues. The trends for the six months ended July 31, 2006 are consistent with those discussed for the three months ended July 31, 2006.
- o Operating margin decreased from 9.1% to 6.7% for the three months ended July 31, 2006 when compared to the same period in the prior year due to reduced gross margin and increased Provision for bad debts that was partially offset by our ability to reduce SG&A expenses as a percent of revenues. The factors above also affected the operating margin for the six months ended July 31, 2006 which decreased from 9.4% during the same period last year to 8.1%.
- 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 July 31, 2006 as compared to \$0.3 million being recorded in the quarter ended July 31, 2005. The adoption resulted in expenses totaling \$0.8 million being recorded to SG&A during the six months ended July 31, 2006 as compared to \$0.5 million being recorded in the six months ended July 31, 2005.

18

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

Operational Changes and Resulting Outlook

During the quarter, we opened a new store in the West Houston market and added a clearance center in Baytown. 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.

Edgar Filing: CONNS INC - Form 10-Q

In its regularly scheduled meeting on August 24, 2006, our Board of Directors authorized the repurchase of up to \$50 million of our common stock, dependent on market conditions and the price of the stock.

The credit portfolio delinquency and charge-off statistics were negatively impacted by the effects of Hurricane Rita that hit the Gulf Coast during September of 2005. The hurricane impacted our customer's ability to pay on their accounts and hampered our credit collection operations, including payment processing delays caused by disruption in the mail service. The credit collection operations were negatively affected by the loss of personnel, as some employees did not return to work, and by the increase in the number of delinquent accounts, resulting in increased workloads for the personnel that returned to work. To address the staffing issues, we have intensified our recruiting efforts to attract individuals to our Beaumont, Texas collection center and have opened a second collection center in Dallas, Texas. Non-storm factors that may have negatively affected delinquencies and charge-offs include the impact of the bankruptcy law change in October 2005 and other economic factors on our customers. However, as predicted, the delinquency performance of the credit portfolio has improved since January 31, 2006, and we expect both the delinquency and loss rates to return to historical levels over the next six months. 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 rates that will be phased in during the 2006 and 2007 property tax years. The tax changes impacted earnings beginning in this quarter. For the quarter and six months ended, we accrued, net of federal tax benefit, \$118,000 in additional tax liability and recorded approximately \$29,000 in net deferred tax assets as a result of the new margin tax. Going forward, we expect our effective tax rate on Income before income taxes to increase to between 36% and 37%, from average of 35.1% over the past three fiscal years.

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

Application of Critical Accounting Policies

In applying the accounting policies that we use to prepare our consolidated financial statements, we necessarily make accounting estimates that affect our

Edgar Filing: CONNS INC - Form 10-Q

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 July 31, 2006.

Transfers of Financial Assets. We transfer customer receivables to the QSPE that issues asset-backed securities to third party lenders using these accounts as collateral, and we continue to service these accounts after the transfer. We recognize the sale of these accounts when we relinquish control of the transferred financial asset in accordance with SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities. As we transfer the accounts, we record an asset representing the interest only strip which is the difference between the interest earned on customer accounts and the cost associated with financing and servicing the transferred accounts, including a provision for bad debts associated with the transferred accounts (on a revolving pool basis) discounted to a market rate of interest. The gain or loss recognized on these transactions is based on our best estimates of key assumptions, including forecasted credit losses based on actual portfolio experience over the past twelve months, payment rates, forward yield curves, costs of servicing the accounts and appropriate discount rates. The use of different estimates or assumptions could produce different financial results. For example, if we had assumed a 10.0% reduction in net interest spread (which might be caused by rising interest rates or reductions in rates charged on the accounts transferred), our interest in securitized assets would have been reduced by \$5.6 million as of July 31, 2006, which may have an adverse affect on earnings. We recognize income from our interest in these transferred accounts as gains on the transfer of the asset, interest income and servicing fees. This income is recorded as Finance charges and other in our consolidated statements of operations. If the assumption used for estimating credit losses 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 of approximately \$0.6 million as of July 31, 2006. If we had assumed that the future tax rate at which these deferred items would reverse was 50 basis points higher than currently anticipated, we would have increased the net deferred tax liability and decreased net income by approximately \$9 thousand.

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

Property and Equipment. Our accounting policies regarding land, buildings, equipment and leasehold improvements include judgments regarding the estimated

Edgar Filing: CONNS INC - Form 10-Q

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.

20

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 July 31, 2006 and January 31, 2006 was \$3.7 million and \$3.6 million, respectively, and is included in Deferred revenues and allowances in the accompanying balance sheets.

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

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

Edgar Filing: CONNS INC - Form 10-Q

Accounting for Leases. The accounting for leases is governed primarily by SFAS No. 13, Accounting for Leases. As required by the standard, we analyze each lease, at its inception, to determine whether it should be accounted for as an operating lease or a capital lease. Additionally, monthly lease expense for each operating lease is calculated as the average of all payments required under the minimum lease term, including rent escalations. Generally, the minimum lease term begins with the date we take possession of the property and ends on the last day of the minimum lease term, and includes all rent holidays, but excludes renewal terms that are at our option. Any tenant improvement allowances received are deferred and amortized into income as a reduction of lease expense on a straight line basis over the minimum lease term. The amortization of leasehold improvements is computed on a straight line basis over the shorter of the remaining lease term or the estimated useful life of the improvements. Effective February 1, 2006 we implemented the requirements of FASB Staff Position No. 13-1, which addresses the accounting for rental costs associated with operating leases that are incurred during a construction period. As required by that guidance, we recognize as rental expense all rental costs associated with ground or building operating leases that are incurred during a construction period. That rental expense is included in income from continuing operations and is not capitalized.

21

Results of Operations

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

	Three Months Ended July 31,	
	2005	2006
Revenues:		
Product sales	79.5 %	
Service maintenance agreement commissions (net)	4.8	
Service revenues	3.1	
Total net sales	87.4	
Finance charges and other	12.6	
Total revenues	100.0	100.0
Costs and expenses:		
Cost of goods sold, including warehousing and occupancy cost	62.9	
Cost of parts sold, including warehousing and occupancy cost	0.8	
Selling, general and administrative expense	27.3	
Provision for bad debts	(0.1)	
Total costs and expenses	90.9	
Operating income	9.1	
Interest (income) expense, net	0.1	
Other (income) expense, net	0.0	

Edgar Filing: CONNS INC - Form 10-Q

Income before income taxes	9.0	
Provision for income taxes	3.2	
	-----	-----
Net income	5.8 %	=====

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.

22

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

Revenues. Total revenues increased by \$17.6 million, or 10.7%, from \$164.6 million for the three months ended July 31, 2005 to \$182.2 million for the three months ended July 31, 2006. The increase was attributable to increases in net sales of \$19.8 million, or 13.8%, offset by a decrease of \$2.1 million, or 10.4%, in finance charges and other revenue.

The \$19.8 million increase in net sales was made up of the following:

- o a \$10.0 million same store sales increase of 7.2%. 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 3.8% in the other markets we serve. These other markets accounted for 78.9% of same store Product sales and Service maintenance agreement commissions during the three months ended July 31, 2006. Service maintenance agreement (SMA) sales have declined due to a lower sales penetration. This decline has been partially offset as a result of changes in the commission structure on our third-party service maintenance agreement (SMA) contracts, beginning July 2005, we began realizing the benefit of increased front-end commissions on SMA sales, which increased net sales by approximately \$0.6 million, (offsetting this increase is a decrease in retrospective commissions which is reflected in Finance charges and other);
- o a \$8.7 million increase generated by seven retail locations that were not open for three consecutive months in each period;
- o a \$0.3 million increase resulted from a decrease in discounts on

Edgar Filing: CONNS INC - Form 10-Q

extended-term promotional credit sales (those with terms longer than 12 months); and

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

The components of the \$19.8 million increase in net sales, were a \$19.8 million increase in Product sales and a \$0.8 million increase in service revenues offset by a net decrease in service maintenance agreement commissions of \$0.8 million. The \$19.8 million increase in product sales resulted from the following:

- o approximately \$15.6 million was attributable to increases in unit sales, due to increased appliances, consumer electronics (especially plasma and LCD televisions), and furniture sales, partially offset by a decline in track sales, and
- o approximately \$4.2 million was attributable to increases in unit price points. The price point impact was driven by a shift to higher-priced track items and increased delivery fees, partially offset by a slight decline in our core product categories as prices for new technology in those areas erode.

23

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 July 31,			
	2005		2006	
	Amount	Percent	Amount	
Major home appliances	\$ 46,579	32.4 %	\$ 53,429	
Consumer electronics	39,728	27.6	46,414	
Track	21,225	14.7	20,257	
Delivery.....	2,376	1.7	2,887	
Lawn and garden	5,943	4.1	6,577	
Mattresses	3,095	2.1	4,908	
Furniture	3,772	2.6	8,245	
Other	8,149	5.7	7,930	
Total product sales	130,867	90.9	150,647	
Service maintenance agreement commissions	7,848	5.5	7,063	
Service revenues	5,134	3.6	5,927	
Total net sales	\$ 143,849	100.0 %	\$ 163,637	

(1) These increases are consistent with overall increase in product

Edgar Filing: CONNS INC - Form 10-Q

- sales and improved unit prices.
- (2) The decline in track sales (consisting largely of computers, computer peripherals, portable electronics and small appliances) is due primarily to reduced sales of computers, portable televisions and camcorders.
 - (3) This increase is due primarily to the increase in total product sales, as well as an increase in the fees charged for deliveries.
 - (4) A delayed selling season due to dry weather impacted this category.
 - (5) This increase is due to increased emphasis on and improved execution at our stores in the sale of this category.
 - (6) This increase is due to the increased emphasis on the sales of furniture, primarily sofas, recliners and entertainment centers, and new product lines added to this category.
 - (7) The decline in this category, which includes air conditioning, is due primarily to growing unit volume by emphasizing products with lower price points to match the competitive environment.

Revenue from Finance charges and other decreased by approximately \$2.1 million, or 10.4%, from \$20.7 million for the three months ended July 31, 2005 to \$18.6 million for the three months ended July 31, 2006. It declined while product sales grew, due primarily to a decrease in securitization income of \$1.9 million, or 12.6% and a \$0.9 million decrease in service maintenance agreement retrospective commissions, partially offset by an increase in insurance commissions of \$0.7 million. Securitization income was impacted primarily by a 74.0% increase in net credit losses in the quarter ended July 31, 2006 as compared to the quarter ended July 31, 2005. The increased net credit losses were due to higher than expected losses primarily as a result of the disruption to our credit operations caused by Hurricane Rita. During the three months ended July 31, 2006, due to the expectation of continued higher losses over the next six months, we recorded an impairment charge of \$1.5 million, reducing the value of our interest in securitized assets. This impairment charge is based on an estimated charge-off rate of approximately 3.6% over the next six months. The charge-off rate used in the securitized asset valuation is expected to return to the level of the historical charge-off rate assumption of 3.0% at the beginning of our next fiscal year. Additionally, securitization income has been negatively impacted by increased interest cost on the borrowings of the QSPE, due to rising interest rates, and slower growth in the credit portfolio, which impacts the interest income earned by the QSPE.

Cost of Goods Sold. Cost of goods sold, including warehousing and occupancy cost, increased by \$16.2 million, or 15.6%, from \$103.6 million for the three months ended July 31, 2005 to \$119.8 million for the three months ended July 31, 2006. This increase was slightly higher than the 15.1% increase in Product sales during the three months ended July 31, 2006. Cost of products sold increased to 79.5% of Product sales in the quarter ended July 31, 2006, as compared to 79.1% in the quarter ended July 31, 2005. The increase in Cost of goods sold as a percentage of Product sales was primarily as a result of higher warehousing costs, which grew faster than sales.

24

Cost of Parts Sold. Cost of parts sold, including warehousing and occupancy cost, increased approximately \$153,000, or 12.4%, for the three months ended July 31, 2006 as compared to the three months ended July 31, 2005, due to increases in parts sales. While Service revenues increased by 15.4% in the quarter ended July 31, 2006 as compared to the quarter ended July 31, 2005, the cost of parts sold increased at a slower rate due to improved inventory management.

Selling, General and Administrative Expense. While Selling, general and administrative expense increased by \$3.4 million, or 7.7%, from \$45.0 million

Edgar Filing: CONNS INC - Form 10-Q

for the three months ended July 31, 2005 to \$48.4 million for the three months ended July 31, 2006, it decreased as a percentage of total revenue from 27.3% to 26.6%. 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, effective February 1, 2006. The adoption resulted in expenses totaling \$0.4 million being recorded to SG&A during the quarter ended July 31, 2006 as compared to \$0.3 million being recorded in the quarter ended July 31, 2005.

Provision for Bad Debts. The provision for bad debts on non-credit portfolio receivables and credit portfolio receivables retained by the Company and not transferred to the QSPE increased by \$0.5 million, during the three months ended July 31, 2006, as compared to the three months ended July 31, 2005, primarily as a result of provision adjustments that reduced expense in the prior year period, and increased expense in the current year due to the impact of the hurricanes. See Note 3 to the financial statements for information regarding the performance of the credit portfolio.

Interest (Income) Expense, net. Net interest (income) expense improved by \$246,000, from net interest expense of \$59,000 for the three months ended July 31, 2005 to net interest income of \$187,000 for the three months ended July 31, 2006. The net improvement in interest (income) expense was primarily attributable to increased interest income from invested funds of approximately \$162,000. The remaining change of \$84,000 resulted from lower average outstanding debt balances and capitalization of interest expense on construction in progress.

Other (Income) Expense, net. Other (income) expense, net improved by \$749,000, from net expense of \$28,000 for the three months ended July 31, 2005, to net income of \$721,000 for the three months ended July 31, 2006. This change was primarily the result of a \$0.7 million gain recognized on the sale of a building and the related land.

Provision for Income Taxes. The provision for income taxes decreased by \$0.6 million, or 12.2%, from \$5.3 million for the three months ended July 31, 2005 to \$4.6 million for the three months ended July 31, 2006. The decrease in the Provision for income taxes is attributable to lower Income before income taxes and state tax refunds received during the period. The impact of the new Texas margin tax was partially offset by the one-time benefit of deferred tax assets recorded as a result of the new tax.

Net Income. As a result of the above factors, Net income decreased \$1.1 million, or 10.9%, from \$9.6 million for the three months ended July 31, 2005 to \$8.5 million for the three months ended July 31, 2006.

Six Months Ended July 31, 2006 Compared to Six Months Ended July 31, 2005

Revenues. Total revenues increased by \$51.9 million, or 16.1%, from \$322.5 million for the six months ended July 31, 2005 to \$374.4 million for the six months ended July 31, 2006. The increase was attributable to increases in net sales of \$52.6 million, or 18.6%, and a decrease of \$0.7 million, or 1.6%, in finance charges and other revenue.

The \$52.6 million increase in net sales was made up of the following:

- o a \$31.9 million same store sales increase of 11.7%. 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 7.8% in the other markets we serve. These other markets accounted for 78.5% of

same store Product sales and Service maintenance agreement commissions during the six months ended July 31, 2006. Additionally, as a result of changes in the commission structure on our third-party service maintenance agreement (SMA) contracts, beginning July 2005, we began realizing the benefit of increased front-end commissions on SMA sales, which increased net sales by approximately \$1.2 million, (offsetting this increase is a decrease in retrospective commissions which is reflected in Finance charges and other);

- o a \$19.5 million increase generated by eight retail locations that were not open for six consecutive months in each period; and
- o a \$1.2 million increase resulted from an increase in service revenues.

The components of the \$52.6 million increase in net sales were a \$51.0 million increase in product sales and a \$1.6 million net increase in service maintenance agreement commissions and service revenues. The \$51.0 million increase in product sales resulted from the following:

- o approximately \$33.8 million was attributable to increases in unit sales, due to increased appliances, consumer electronics (especially plasma and LCD televisions), and furniture sales, partially offset by a decline in track sales, and
- o approximately \$17.2 million was attributable to increases in unit price points. The price point impact was driven by a shift to higher-priced track items and increased delivery fees, as well as consumers selecting higher priced appliance products, including high-efficiency washers and dryers and stainless kitchen appliances, partially offset by a slight decline in electronics as prices for new technology erode.

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	Six Months Ended July 31,			
	2005		2006	
	Amount	Percent	Amount	Percent
Major home appliances	\$ 93,181	33.0 %	\$ 115,293	33.0 %
Consumer electronics	83,381	29.5	100,050	29.5
Track	43,965	15.5	43,462	15.5
Delivery.....	4,400	1.5	5,759	1.5
Lawn and garden	11,226	4.0	11,693	4.0
Mattresses.....	6,002	2.1	10,004	2.1
Furniture	6,768	2.4	13,650	2.4
Other	9,219	3.3	9,245	3.3

Edgar Filing: CONNS INC - Form 10-Q

Total product sales	258,142	91.3	309,156	
Service maintenance agreement commissions	14,732	5.2	15,030	
Service revenues	9,909	3.5	11,156	
Total net sales	\$ 282,783	100.0 %	\$ 335,342	10
	=====	=====	=====	=====

-
- (1) These increases are consistent with overall increase in product sales and improved unit prices.
 - (2) The decline in track sales (consisting largely of computers, computer peripherals, portable electronics and small appliances) is due primarily to reduced sales of computers, portable televisions and camcorders.
 - (3) This increase is due primarily to the increase in total product sales, as well as an increase in the fees charged for deliveries.
 - (4) A delayed selling season due to dry weather impacted this category.
 - (5) This increase is due to increased emphasis on and improved execution at our stores in the sale of this category.

26

- (6) This increase is due to the increased emphasis on the sales of furniture, primarily sofas, recliners and entertainment centers, and new product lines added to this category.
- (7) This category, which includes air conditioning, was impacted significantly as we grew unit volume by emphasizing products with lower price points to match the competitive environment.

Revenue from Finance charges and other decreased by approximately \$0.7 million, or 1.6%, from \$39.7 million for the six months ended July 31, 2005, to \$39.0 million for the six months ended July 31, 2006. The slight decrease was caused by a \$1.6 million decrease in service maintenance agreement retrospective commissions, partially offset by an increase in securitization income of \$0.2 million and a \$0.7 million increase in insurance commissions and other. Securitization income was impacted primarily by a 69.9% increase in net credit losses in the six months ended July 31, 2006 as compared to the six months ended July 31, 2005. The increased net credit losses were due to higher than expected losses primarily as a result of the disruption to our credit operations caused by Hurricane Rita. During the six months ended July 31, 2006, due to the expectation of continued higher losses over the next six months, we recorded an impairment charge of \$1.5 million, reducing the value of our interest in securitized assets. This impairment charge is based on an estimated charge-off rate of approximately 3.6% over the next six months. The charge-off rate used in the securitized asset valuation is expected to return to the level of the historical charge-off rate assumption of 3.0% at the beginning of our next fiscal year. Additionally, securitization income has been negatively impacted by increased interest cost on the borrowings of the QSPE, due to rising interest rates, and slower growth in the credit portfolio, which impacts the interest income earned by the QSPE.

Cost of Goods Sold. Cost of goods sold, including warehousing and occupancy cost, increased by \$41.0 million, or 20.0%, from \$204.5 million for the six months ended July 31, 2005 to \$245.5 million for the six months ended July 31, 2006. This increase was slightly higher than the 19.8% increase in Product sales during the six months ended July 31, 2006. Cost of products sold increased to 79.4% of Product sales in the six months ended July 31, 2006, as compared to 79.2% in the six months ended July 31, 2005. The increase in Cost of goods sold as a percentage of Product sales was primarily as a result of higher warehousing costs, which grew faster than sales.

Edgar Filing: CONNS INC - Form 10-Q

Cost of Parts Sold. Cost of parts sold, including warehousing and occupancy cost, increased approximately \$0.5 million, or 20.0%, for the six months ended July 31, 2006 as compared to the six months ended July 31, 2005, due to increases in parts sales. While Service revenues increased by 12.6% in the six months ended July 31, 2006 as compared to the six months ended July 31, 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 \$10.4 million, or 12.3%, from \$84.7 million for the six months ended July 31, 2005 to \$95.1 million for the six months ended July 31, 2006, it decreased as a percentage of total revenue from 26.3% to 25.4%. 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, effective February 1, 2006. The adoption resulted in expenses totaling \$0.8 million being recorded to SG&A during the six months ended July 31, 2006 as compared to \$0.5 million being recorded in the six months ended July 31, 2005.

Provision for Bad Debts. The provision for bad debts on non-credit portfolio receivables and credit portfolio receivables retained by the Company and not transferred to the QSPE increased by \$0.1 million, during the six months ended July 31, 2006, as compared to the six months ended July 31, 2005, primarily as a result of provision adjustments that reduced expense in the prior year period, and increased expense in the current year due to the impact of the hurricanes. See Note 3 to the financial statements for information regarding the performance of the credit portfolio.

27

Interest (Income) Expense, net. Net interest (income) expense improved by \$785,000, from net interest expense of \$414,000 for the six months ended July 31, 2005 to net interest income of \$371,000 for the six months ended July 31, 2006. The net improvement in interest (income) expense was primarily attributable to:

- o the expiration of \$20.0 million of our interest rate hedges and the discontinuation of hedge accounting resulted in a net decrease in interest expense of approximately \$244,000; and
- o increased interest income from invested funds of approximately \$378,000.

The remaining change of \$163,000 resulted from lower average outstanding debt balances and capitalization of interest expense on construction in progress.

Other (Income) Expense, net. Other (income) expense, net improved by \$788,000, from net expense of \$34,000 for the six months ended July 31, 2005, to net income of \$754,000 for the six months ended July 31, 2006. This change was primarily the result of a \$0.7 million gain recognized on the sale of a building and the related land.

Provision for Income Taxes. The provision for income taxes increased by \$0.5 million, or 4.4%, from \$10.6 million for the six months ended July 31, 2005 to \$11.1 million for the six months ended July 31, 2006. The increase in the Provision for income taxes is attributable to higher Income before income taxes, partially offset by state tax refunds received during the period. The impact of the new Texas margin tax was partially offset by the one-time benefit of

Edgar Filing: CONNS INC - Form 10-Q

deferred tax assets recorded as a result of the new tax.

Net Income. As a result of the above factors, Net income increased \$1.0 million, or 5.3%, from \$19.5 million for the six months ended July 31, 2005 to \$20.5 million for the six months ended July 31, 2006.

Liquidity and Capital Resources

Current Activities

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

As of July 31, 2006, we had approximately \$15.0 million in excess cash, the majority of which was generated through the operations of the Company. In addition to the excess cash, we had \$48.6 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, \$21.2 million under extended vendor terms for purchases of inventory and \$61.0 million in commitments available to our QSPE for the transfer of receivables.

In its regularly scheduled meeting on August 24, 2006, our Board of Directors authorized the repurchase of up to \$50 million of our common stock, dependent on market conditions and the price of the stock. We expect to fund these purchases with a combination of excess cash, cash flow from operations, borrowings under our revolving credit facilities and proceeds from the sale of owned properties.

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

28

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

	Actual	Requ Mini Maxi
	-----	-----
Debt service coverage ratio must exceed required minimum	4.37 to 1.00	2.00 t
Total adjusted leverage ratio must be lower than required maximum	1.60 to 1.00	3.00 t
Consolidated net worth must exceed required minimum	\$268.1 million	\$162.0
Charge-off ratio must be lower than required maximum	0.03 to 1.00	0.06 t
Extension ratio must be lower than required maximum	0.03 to 1.00	0.05 t
Thirty-day delinquency ratio must be lower than required maximum	0.08 to 1.00	0.13 t

Note: All terms in the above table are defined by the bank credit facility

Edgar Filing: CONNS INC - Form 10-Q

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:

- 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 and primary versus secondary portfolio);
- 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.

During the six months ended July 31, 2006, net cash provided by operating activities decreased \$45.4 million from \$31.4 million provided in the 2005 period to \$14.0 million used in the 2006 period. The net decrease in cash provided from operations resulted primarily from the timing of payments of accounts payable and federal income and employment tax payments. We had obtained extended payment terms from several of our vendors due to the impact of hurricanes in the prior fiscal year. Federal income and employment tax payment deadlines after Hurricane Rita were also deferred until February 28, 2006.

Edgar Filing: CONNS INC - Form 10-Q

Those extended terms ended and deadlines were reached in the six months ended July 31, 2006 and we were required to satisfy those obligations, which negatively impacted our operating cash flows by approximately \$18.9 million. Additionally, during the six months ended July 31, 2006, cash flow was used to increase inventory, as new stores have been added, and to finance growth in the credit portfolio, as we have been required to increase our retained interest in the receivables due to the increased credit losses.

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 period. The percentage of eligible securitized receivables represented by promotional receivables was 17.0% as of July 31, 2006. At July 31, 2005, this percentage, computed on a consistent basis with the July 31, 2006 calculation, would have been 22.4%. The weighted average promotional period was 12.7 months and 11.5 months for promotional receivables outstanding as of July 31, 2005 and 2006, respectively. The weighted average remaining term on those same promotional receivables was 8.2 months and 7.2 months, respectively. While overall these promotional receivables have a much shorter weighted average term than non-promotional receivables, we receive less income on these receivables, resulting in a reduction of the net interest margin used in the calculation of the gain on the sale of receivables.

Net cash used by investing activities decreased by \$0.4 million, from \$10.0 million for the six months ended July 31, 2005 to \$9.6 million for the six months ended July 31, 2006. The decrease in cash used in investing activities resulted primarily from the sales of property and equipment, partially offset by increased purchases of property and equipment. The cash expended for property and equipment was used primarily for construction of new stores and the reformatting of existing stores to better support our current product mix. Based on current plans, we expect to increase expenditures for property and equipment in fiscal 2007 as we open additional stores, including ownership and development of shopping centers that will feature our store, as compared to fiscal 2006. Additionally, we intend to sell and lease-back certain of the properties we currently own, in order to provide cash flow for funding our growth and stock repurchase plans.

Net cash from financing activities increased by \$10.8 million from \$9.4 million used during the six months ended July 31, 2005 to \$1.4 million provided during the six months ended July 31, 2006. The increase in cash provided by financing activities resulted primarily from decreases in payments on various debt instruments of \$10.5 million. Also benefiting cash flow from financing activities was increased proceeds from stock issued under employee benefit plans.

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

Edgar Filing: CONNS INC - Form 10-Q

receivables, consisting of retail installment contracts and revolving accounts extended to our customers, to the issuer in exchange for cash and subordinated, unsecured promissory notes. To finance its acquisition of these receivables, the issuer has issued the notes and bonds described below to third parties. The unsecured promissory notes issued to us are subordinate to these third party notes and bonds.

At July 31, 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 July 31, 2006, the net portfolio yield was in compliance with this requirement. Private institutional investors, primarily insurance companies, purchased the Series B bonds at a weighted fixed rate of 5.25%.

30

In August 2006, the issuer entered into an amendment of the Series A note to increase the total available funding to \$300 million, divided into a \$100 million 364-day tranche, and a \$200 million tranche that expires in August 2011. The Company's QSPE closed and consummated an offering, pursuant to Rule 144A and Regulation S under the Securities Act of 1933, of \$150 million of asset-backed fixed-rate notes (Series 2006A bonds), the net proceeds of which were used primarily to provide the QSPE with additional capacity, fund the required \$6.0 million cash reserve account and to reduce the amount outstanding under the existing 2002 variable funding note. The proceeds of the new issuance provide the issuer additional capacity for the purchase of our receivables and to make the \$10 million monthly principal payments on the Series B bonds due beginning in October 2006. Private institutional investors, primarily insurance companies, purchased the Series 2006A bonds at a weighted fixed rate of 5.75%.

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

- o increase our consolidated net worth requirement from \$30 million to \$150 million;
- o add certain return mail procedures to the internal accounting control procedures and processing functions report delivered by independent accountants pursuant to the servicing agreement;
- o change the definition of "Eligible Installment Contract Receivable" under the base indenture to allow up to 27.5% of all receivables by outstanding principal balance to consist of installment contract receivables of the secondary portfolio (formerly 25% of such receivables were permitted);
- o change the definition of "Eligible Installment Contract Receivable" and "Eligible Revolving Charge Receivable" under the base indenture to allow up to 5.0% of the amount or number of installment contract and revolving charge receivables, whichever occurs first, to have a maximum repayment period and cash option period exceeding thirty-six months but no more than forty-eight months (secondary portfolio maximum term remains thirty-six months);
- o change certain definitions under the series supplements for the Series A notes and the Series B bonds, including changes to the

Edgar Filing: CONNS INC - Form 10-Q

series supplements for the Series A notes that have the effect of increasing the current level of funding available to the issuer; and

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

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

After August, 2006 amendment, the Series A variable funding note now permits the issuer to borrow funds up to \$300 million to purchase receivables from us, thereby functioning as a "basket" to accumulate receivables. As issuer borrowings under the Series A variable funding note approach \$300 million, the issuer is required to request an increase in the Series A amount or issue a new series of bonds and use the proceeds to pay down the then outstanding balance of the Series A variable funding note, so that the basket will once again become available to accumulate new receivables or meet other obligations required under the transaction documents. As of July 31, 2006, borrowings under the Series A variable funding note were \$189.0 million.

31

We are not directly liable to the lenders under the asset-backed securitization facility. If the issuer is unable to repay the Series A note, Series B bonds and Series 2006A bonds due to its inability to collect the transferred customer accounts, the issuer could not pay the subordinated notes it has issued to us in partial payment for transferred customer accounts, the Series B and Series 2006A bond holders could claim the balance in its \$14.0 million restricted cash account. We are also contingently liable under a \$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. We plan to renew this letter of credit and increase the amount to \$20.0 million in September, 2006.

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

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

Edgar Filing: CONNS INC - Form 10-Q

	As reported	Required Minimum/ Maximum
	-----	-----
Issuer interest must exceed required minimum	\$47.6 million	\$42.3 million
Gross loss rate must be lower than required maximum	4.5%	10.0%
Net portfolio yield must exceed required minimum	7.4%	2.0%
Payment rate must exceed required minimum	6.7%	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.

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

32

Securitization Facilities

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

[FLOWCHART OMITTED]

Both the bank credit facility and the asset-backed securitization program are significant factors relative to our ongoing liquidity and our ability to meet the cash needs associated with the growth of our business. Our inability to use either of these programs because of a failure to comply with their covenants would adversely affect our continued growth. Funding of current and future receivables under the QSPE's asset-backed securitization program can be adversely affected if we exceed certain predetermined levels of re-aged receivables, size of the secondary portfolio, the amount of promotional receivables, write-offs, bankruptcies or other ineligible receivable amounts. If the funding under the QSPE's asset-backed securitization program was reduced or terminated, we would have to draw down our bank credit facility more quickly than we have estimated.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest rates under our bank credit facility (as executed October 31, 2005) are variable and are determined, at our option, as the base rate, which is the greater of prime rate or federal funds rate plus 0.50% plus the base rate margin, which ranges from 0.00% to 0.50%, or LIBOR plus the LIBOR margin, which ranges from 0.75% to 1.75%. Accordingly, changes in the prime rate, the federal funds rate or LIBOR, which are affected by changes in interest rates generally, will affect the interest rate on, and therefore our costs under, our bank credit

Edgar Filing: CONNS INC - Form 10-Q

facility. We are also exposed to interest rate risk associated with our interest only strip and the subordinated securities we receive from our sales of receivables to the QSPE.

We held interest rate swaps and collars with notional amounts totaling \$20.0 million which expired on April, 15 2005. The swaps and collars were held for the purpose of hedging against variable interest rate risk, primarily related to cash flows from our interest-only strip as well as our variable rate debt. There have been no material changes in our interest rate risks since January 31, 2006.

33

Item 4. Controls and Procedures

An evaluation was performed under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, regarding the effectiveness of our disclosure controls and procedures (as defined in 15d-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act") as of the end of the period covered by this quarterly report. Based on that evaluation, our management, including our Chief Executive Officer and our Chief Financial Officer, concluded that our disclosure controls and procedures are effective in timely alerting them to material information relating to our Company (including its consolidated subsidiaries) required to be included in our periodic filings with the Securities and Exchange Commission.

During the preparation of our consolidated financial statements for the quarter ended July 31, 2006, we identified an issue related to the recording of securitization income. Based on our discovery and the results of discussions with our independent accountants and the Audit Committee of the Board of Directors, it was determined that a review of our accounting under SFAS No. 140 should be completed before the statements for the quarter ended July 31, 2006 were issued. The internal review revealed that we had incorrectly reduced securitization income and the value of our interests in securitized assets by the amount of future expected loan losses recorded on the books of the qualifying special purpose entity that owns the receivables.

As a result of the error discussed above and the resulting restatement, management has concluded that a material weakness in its internal controls over financial reporting existed prior to the completion of the consolidated financial statement for quarter ended July 31, 2006. Specifically, controls were not operating effectively to ensure that the proper accounting and corresponding consolidated financial statement presentation of securitization income and the fair value of interests in securitized assets was consistent with SFAS No. 140.

As of the date of this filing, we believe we have taken the appropriate action to remediate the material weakness in our internal control over financial reporting with respect to accounting for securitization transactions, based on the following actions taken:

- o improved education and enhanced accounting analysis and reviews designed to ensure that all relevant personnel involved in the securitization accounting understand and account for securitization transactions in compliance with SFAS No. 140; and
- o a review of our internal financial controls with respect to accounting for securitization transactions to ensure compliance with SFAS No. 140.

While we believe we have taken the steps necessary to remediate this material weakness relating to our accounting under SFAS No. 140 and related

Edgar Filing: CONNS INC - Form 10-Q

processes, procedures, and controls, we cannot confirm the effectiveness of our enhanced internal controls with respect to our accounting under SFAS No. 140 until we and our independent auditors have conducted sufficient tests. Accordingly, we will continue to monitor the effectiveness of the processes, procedures, and controls we have implemented and will make any further changes management determines appropriate.

As described above, we made changes in internal controls over financial reporting during the quarter ended July 31, 2006, that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

We are involved in routine litigation incidental to our business from time to time. Currently, we do not expect the outcome of any of this routine litigation to have a material effect on our financial condition or results of operation. However, the results of these proceedings cannot be predicted with certainty, and changes in facts and circumstances could impact our estimate of reserves for litigation.

34

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended January 31, 2006, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

Item 4. Submission of Matters to a Vote of Security Holders

At the Annual Meeting of Stockholders held on May 31, 2006, the following proposals were submitted to stockholders with the following results:

1. Election of nine directors

	Number of Shares	
	For	Withheld
Marvin D. Brailsford	21,681,563	521,915
Thomas J. Frank, Sr.	21,430,983	772,495
Jon E. M. Jacoby	21,468,729	734,749
Bob L. Martin	21,515,399	688,079
Douglas H. Martin	21,570,630	632,848
Dr. William C. Nylin, Jr.	21,408,662	794,816
Scott L. Thompson	21,679,181	524,297
William T. Trawick	14,907,089	7,296,389
Theodore M. Wright	21,120,181	1,083,297

2. Approval of 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.

Edgar Filing: CONNS INC - Form 10-Q

	Number of Shares
For	17,994,641
Against	1,665,663
Abstain	10,271
Broker Nonvotes	2,532,903

3. Approval of 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.

	Number of Shares
For	17,156,306
Against	2,504,099
Abstain	10,170
Broker Nonvotes	2,532,903

35

Item 5. Other Information

There have been no material changes to the procedures by which security holders may recommend nominees to our board of directors since we last provided disclosure in response to the requirements of Item 7(d)(2)(ii)(G) of Schedule 14A.

The Company expects to reinstate the full salaries of three of its named officers effective September 16, 2006, who voluntarily took a temporary reduction in their base salary effective August 16, 2006. The three executives are Thomas J. Frank, Sr., Chairman of the Board of Directors and Chief Executive Officer, Dr. William C. Nylin, Jr., the Company's Chief Operating Officer and Executive Vice Chairman of the Board of Directors and Reymundo de la Fuente, Senior Vice President - Credit. The base salaries will be reinstated fully to the levels prior to the voluntary reduction.

Item 6. Exhibits

The exhibits required to be furnished pursuant to Item 6 of Form 10-Q are listed in the Exhibit Index filed herewith, which Exhibit Index is incorporated herein by reference.

36

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

CONN'S, INC.

By: /s/ David L. Rogers

David L. Rogers
Chief Financial Officer
(Principal Financial Officer and
duly authorized to sign this
report on behalf of the
registrant)

Date: September 15, 2006

INDEX TO EXHIBITS

Exhibit Number	Description
2	Agreement and Plan of Merger dated January 15, 2003, by and among Conn's, Inc., Conn Appliances, Inc. and Conn's Merger Sub, Inc. (incorporated herein by reference to Exhibit 2 to Conn's, Inc. registration statement on Form S-1 (file no. 333-109046) as filed with the Securities and Exchange Commission on September 23, 2003).
3.1	Certificate of Incorporation of Conn's, Inc. (incorporated herein by reference to Exhibit 3.1 to Conn's, Inc. registration statement on Form S-1 (file no. 333-109046) as filed with the Securities and Exchange Commission on September 23, 2003).
3.1.1	Certificate of Amendment to the Certificate of Incorporation of Conn's, Inc. dated June 3, 2004 (incorporated herein by reference to Exhibit 3.1.1 to Conn's, Inc. Form 10-Q for the quarterly period ended April 30, 2004 (File No. 000-50421) as filed with the Securities and Exchange Commission on June 7, 2004).
3.2	Bylaws of Conn's, Inc. (incorporated herein by reference to Exhibit 3.2 to Conn's, Inc. registration statement on Form S-1 (file no. 333-109046) as filed with the Securities and Exchange Commission on September 23, 2003).
3.2.1	Amendment to the Bylaws of Conn's, Inc. (incorporated herein by reference to Exhibit 3.2.1 to Conn's Form 10-Q for the quarterly period ended April 30, 2004 (File No. 000-50421) as filed with the Securities and Exchange Commission on June 7, 2004).
4.1	Specimen of certificate for shares of Conn's, Inc.'s common stock (incorporated herein by reference to Exhibit 4.1 to Conn's, Inc. registration statement on Form S-1 (file no. 333-109046) as filed with the Securities and Exchange Commission on October 29, 2003).
10.1	Amended and Restated 2003 Incentive Stock Option Plan (incorporated herein by reference to Exhibit 10.1 to Conn's, Inc. registration statement on Form S-1 (file no. 333-109046) as filed with the Securities and Exchange Commission on September 23, 2003).t
10.1.1	Amendment to the Conn's, Inc. Amended and Restated 2003 Incentive Stock Option Plan (incorporated herein by reference to Exhibit 10.1.1 to Conn's Form 10-Q for the quarterly period ended April 30, 2004 (File No. 000-50421) as filed with the Securities and Exchange Commission on June 7, 2004).t
10.1.2	Form of Stock Option Agreement (incorporated herein by reference to Exhibit 10.1.2 to Conn's, Inc. Form 10-K for the annual period ended January 31, 2005 (File No. 000-50421) as filed with the Securities

Edgar Filing: CONNS INC - Form 10-Q

and Exchange Commission on April 5, 2005).t

10.2 2003 Non-Employee Director Stock Option Plan (incorporated herein by reference to Exhibit 10.2 to Conn's, Inc. registration statement on Form S-1 (file no. 333-109046) as filed with the Securities and Exchange Commission on September 23, 2003).t

10.2.1 Form of Stock Option Agreement (incorporated herein by reference to Exhibit 10.2.1 to Conn's, Inc. Form 10-K for the annual period ended January 31, 2005 (File No. 000-50421) as filed with the Securities and Exchange Commission on April 5, 2005).t

10.3 Employee Stock Purchase Plan (incorporated herein by reference to Exhibit 10.3 to Conn's, Inc. registration statement on Form S-1 (file no. 333-109046) as filed with the Securities and Exchange Commission on September 23, 2003).t

38

10.4 Conn's 401(k) Retirement Savings Plan (incorporated herein by reference to Exhibit 10.4 to Conn's, Inc. registration statement on Form S-1 (file no. 333-109046) as filed with the Securities and Exchange Commission on September 23, 2003).t

10.5 Shopping Center Lease Agreement dated May 3, 2000, by and between Beaumont Development Group, L.P., f/k/a Fiesta Mart, Inc., as Lessor, and CAI, L.P., as Lessee, for the property located at 3295 College Street, Suite A, Beaumont, Texas (incorporated herein by reference to Exhibit 10.5 to Conn's, Inc. registration statement on Form S-1 (file no. 333-109046) as filed with the Securities and Exchange Commission on September 23, 2003).

10.5.1 First Amendment to Shopping Center Lease Agreement dated September 11, 2001, by and among Beaumont Development Group, L.P., f/k/a Fiesta Mart, Inc., as Lessor, and CAI, L.P., as Lessee, for the property located at 3295 College Street, Suite A, Beaumont, Texas (incorporated herein by reference to Exhibit 10.5.1 to Conn's, Inc. registration statement on Form S-1 (file no. 333-109046) as filed with the Securities and Exchange Commission on September 23, 2003).

10.6 Industrial Real Estate Lease dated June 16, 2000, by and between American National Insurance Company, as Lessor, and CAI, L.P., as Lessee, for the property located at 8550-A Market Street, Houston, Texas (incorporated herein by reference to Exhibit 10.6 to Conn's, Inc. registration statement on Form S-1 (file no. 333-109046) as filed with the Securities and Exchange Commission on September 23, 2003).

10.6.1 First Renewal of Lease dated November 24, 2004, by and between American National Insurance Company, as Lessor, and CAI, L.P., as Lessee, for the property located at 8550-A Market Street, Houston, Texas (incorporated herein by reference to Exhibit 10.6.1 to Conn's, Inc. Form 10-K for the annual period ended January 31, 2005 (File No. 000-50421) as filed with the Securities and Exchange Commission on April 5, 2005).

10.7 Lease Agreement dated December 5, 2000, by and between Prologis Development Services, Inc., f/k/a The Northwestern Mutual Life Insurance Company, as Lessor, and CAI, L.P., as Lessee, for the property located at 4810 Eisenhower Road, Suite 240, San Antonio, Texas (incorporated herein by reference to Exhibit 10.7 to Conn's, Inc. registration statement on Form S-1 (file no. 333-109046) as

Edgar Filing: CONNS INC - Form 10-Q

filed with the Securities and Exchange Commission on September 23, 2003).

- 10.7.1 Lease Amendment No. 1 dated November 2, 2001, by and between Prologis Development Services, Inc., f/k/a The Northwestern Mutual Life Insurance Company, as Lessor, and CAI, L.P., as Lessee, for the property located at 4810 Eisenhower Road, Suite 240, San Antonio, Texas (incorporated herein by reference to Exhibit 10.7.1 to Conn's, Inc. registration statement on Form S-1 (file no. 333-109046) as filed with the Securities and Exchange Commission on September 23, 2003).
- 10.8 Lease Agreement dated June 24, 2005, by and between Cabot Properties, Inc. as Lessor, and CAI, L.P., as Lessee, for the property located at 1132 Valwood Parkway, Carrollton, Texas (incorporated herein by reference to Exhibit 99.1 to Conn's, Inc. Current Report on Form 8-K (file no. 000-50421) as filed with the Securities and Exchange Commission on June 29, 2005).
- 10.9 Credit Agreement dated October 31, 2005, by and among Conn Appliances, Inc. and the Borrowers thereunder, the Lenders party thereto, JPMorgan Chase Bank, National Association, as Administrative Agent, Bank of America, N.A., as Syndication Agent, and SunTrust Bank, as Documentation Agent (incorporated herein by reference to Exhibit 10.9 to Conn's, Inc. Quarterly Report on Form 10-Q (file no. 000-50421) as filed with the Securities and Exchange Commission on December 1, 2005).
- 10.9.1 Letter of Credit Agreement dated November 12, 2004 by and between Conn Appliances, Inc. and CAI Credit Insurance Agency, Inc., the financial institutions listed on the signature pages thereto, and JPMorgan Chase Bank, as Administrative Agent (incorporated herein by reference to Exhibit 99.2 to Conn's Inc. Current Report on Form 8-K (File No. 000-50421) as filed with the Securities and Exchange Commission on November 17, 2004).
- 39
- 10.9.2 First Amendment to Credit Agreement dated August 28, 2006 by and between Conn Appliances, Inc. and CAI Credit Insurance Agency, Inc., the financial institutions listed on the signature pages thereto, and JPMorgan Chase Bank, as Administrative Agent (incorporated herein by reference to Exhibit 10.1 to Conn's Inc. Current Report on Form 8-K (File No. 000-50421) as filed with the Securities and Exchange Commission on August 28, 2006).
- 10.10 Receivables Purchase Agreement dated September 1, 2002, by and among Conn Funding II, L.P., as Purchaser, Conn Appliances, Inc. and CAI, L.P., collectively as Originator and Seller, and Conn Funding I, L.P., as Initial Seller (incorporated herein by reference to Exhibit 10.10 to Conn's, Inc. registration statement on Form S-1 (file no. 333-109046) as filed with the Securities and Exchange Commission on September 23, 2003).
- 10.10.1 First Amendment to Receivables Purchase Agreement dated August 1, 2006, by and among Conn Funding II, L.P., as Purchaser, Conn Appliances, Inc. and CAI, L.P., collectively as Originator and Seller (filed herewith).
- 10.11 Base Indenture dated September 1, 2002, by and between Conn Funding II, L.P., as Issuer, and Wells Fargo Bank Minnesota, National

Edgar Filing: CONNS INC - Form 10-Q

Association, as Trustee (incorporated herein by reference to Exhibit 10.11 to Conn's, Inc. registration statement on Form S-1 (file no. 333-109046) as filed with the Securities and Exchange Commission on September 23, 2003).

- 10.11. 1 First Supplemental Indenture dated October 29, 2004 by and between Conn Funding II, L.P., as Issuer, and Wells Fargo Bank, National Association, as Trustee (incorporated herein by reference to Exhibit 99.1 to Conn's, Inc. Current Report on Form 8-K (File No. 000-50421) as filed with the Securities and Exchange Commission on November 4, 2004).
- 10.11. 2 Second Supplemental Indenture dated August 1, 2006 by and between Conn Funding II, L.P., as Issuer, and Wells Fargo Bank, National Association, as Trustee (incorporated herein by reference to Exhibit 99.1 to Conn's, Inc. Current Report on Form 8-K (File No. 000-50421) as filed with the Securities and Exchange Commission on August 23, 2006).
- 10.12 Series 2002-A Supplement to Base Indenture dated September 1, 2002, by and between Conn Funding II, L.P., as Issuer, and Wells Fargo Bank Minnesota, National Association, as Trustee (incorporated herein by reference to Exhibit 10.12 to Conn's, Inc. registration statement on Form S-1 (file no. 333-109046) as filed with the Securities and Exchange Commission on September 23, 2003).
- 10.12.1 Amendment to Series 2002-A Supplement dated March 28, 2003, by and between Conn Funding II, L.P. as Issuer, and Wells Fargo Bank Minnesota, National Association, as Trustee (incorporated herein by reference to Exhibit 10.12.1 to Conn's, Inc. Form 10-K for the annual period ended January 31, 2005 (File No. 000-50421) as filed with the Securities and Exchange Commission on April 5, 2005).
- 10.12.2 Amendment No. 2 to Series 2002-A Supplement dated July 1, 2004, by and between Conn Funding II, L.P., as Issuer, and Wells Fargo Bank Minnesota, National Association, as Trustee (incorporated herein by reference to Exhibit 10.12.2 to Conn's, Inc. Form 10-K for the annual period ended January 31, 2005 (File No. 000-50421) as filed with the Securities and Exchange Commission on April 5, 2005).
- 10.12.3 Amendment No. 3 to Series 2002-A Supplement. dated August 1, 2006, by and between Conn Funding II, L.P., as Issuer, and Wells Fargo Bank, National Association, as Trustee (filed herewith).
- 10.13 Series 2002-B Supplement to Base Indenture dated September 1, 2002, by and between Conn Funding II, L.P., as Issuer, and Wells Fargo Bank Minnesota, National Association, as Trustee (incorporated herein by reference to Exhibit 10.13 to Conn's, Inc. registration statement on Form S-1 (file no. 333-109046) as filed with the Securities and Exchange Commission on September 23, 2003).
- 40
- 10.13.1 Amendment to Series 2002-B Supplement dated March 28, 2003, by and between Conn Funding II, L.P., as Issuer, and Wells Fargo Bank Minnesota, National Association, as Trustee (incorporated herein by reference to Exhibit 10.13.1 to Conn's, Inc. Form 10-K for the annual period ended January 31, 2005 (File No. 000-50421) as filed with the Securities and Exchange Commission on April 5, 2005).
- 10.14 Servicing Agreement dated September 1, 2002, by and among Conn Funding II, L.P., as Issuer, CAI, L.P., as Servicer, and Wells Fargo

Edgar Filing: CONNS INC - Form 10-Q

Bank Minnesota, National Association, as Trustee (incorporated herein by reference to Exhibit 10.14 to Conn's, Inc. registration statement on Form S-1 (file no. 333-109046) as filed with the Securities and Exchange Commission on September 23, 2003).

- 10.14.1 First Amendment to Servicing Agreement dated June 24, 2005, by and among Conn Funding II, L.P., as Issuer, CAI, L.P., as Servicer, and Wells Fargo Bank, National Association, as Trustee (incorporated herein by reference to Exhibit 10.14.1 to Conn's, Inc. Form 10-Q for the quarterly period ended July 31, 2005 (File No. 000-50421) as filed with the Securities and Exchange Commission on August 30, 2005).
- 10.14.2 Second Amendment to Servicing Agreement dated November 28, 2005, by and among Conn Funding II, L.P., as 10.14.2 Issuer, CAI, L.P., as Servicer, and Wells Fargo Bank, National Association, as Trustee (incorporated herein by reference to Exhibit 10.14.2 to Conn's, Inc. Form 10-Q for the quarterly period ended October 31, 2005 (File No. 000-50421) as filed with the Securities and Exchange Commission on December 1, 2005).
- 10.14.3 Third Amendment to Servicing Agreement dated May 16, 2006, by and among Conn Funding II, L.P., as Issuer, CAI, L.P., as Servicer, and Wells Fargo Bank, National Association, as Trustee (filed herewith).
- 10.14.4 Fourth Amendment to Servicing Agreement dated August 1, 2006, by and among Conn Funding II, L.P., as Issuer, CAI, L.P., as Servicer, and Wells Fargo Bank, National Association, as Trustee (filed herewith).
- 10.15 Form of Executive Employment Agreement (incorporated herein by reference to Exhibit 10.15 to Conn's, Inc. registration statement on Form S-1 (file no. 333-109046) as filed with the Securities and Exchange Commission on October 29, 2003).t
- 10.15.1 First Amendment to Executive Employment Agreement between Conn's, Inc. and Thomas J. Frank, Sr., Approved by the stockholders May 26, 2005 (incorporated herein by reference to Exhibit 10.15.1 to Conn's, Inc. Form 10-Q for the quarterly period ended July 31, 2005 (file No. 000-50421) as filed with the Securities and Exchange Commission on August 30, 2005).t
- 10.16 Form of Indemnification Agreement (incorporated herein by reference to Exhibit 10.16 to Conn's, Inc. registration statement on Form S-1 (file no. 333-109046) as filed with the Securities and Exchange Commission on September 23, 2003).t
- 10.17 2007 Bonus Program (incorporated herein by reference to Form 8-K (file no. 000-50421) filed with the Securities and Exchange Commission on March 30, 2006).t
- 10.18 Description of Compensation Payable to Non-Employee Directors (incorporated herein by reference to Form 8-K (file no. 000-50421) filed with the Securities and Exchange Commission on June 2, 2005).t
- 10.19 Dealer Agreement between Conn Appliances, Inc. and Voyager Service Programs, Inc. effective as of January 1, 1998 (incorporated herein by reference to Exhibit 10.19 to Conn's, Inc. Form 10-K for the annual period ended January 31, 2006 (File No. 000-50421) as filed with the Securities and Exchange Commission on March 30, 2006).

Edgar Filing: CONNS INC - Form 10-Q

- 10.19.1 Amendment #1 to Dealer Agreement by and among Conn Appliances, Inc., CAI, L.P., Federal Warranty Service Corporation and Voyager Service Programs, Inc. effective as of July 1, 2005 (incorporated herein by reference to Exhibit 10.19.1 to Conn's, Inc. Form 10-K for the annual period ended January 31, 2006 (File No. 000-50421) as filed with the Securities and Exchange Commission on March 30, 2006).
- 10.19.2 Amendment #2 to Dealer Agreement by and among Conn Appliances, Inc., CAI, L.P., Federal Warranty Service Corporation and Voyager Service Programs, Inc. effective as of July 1, 2005 (incorporated herein by reference to Exhibit 10.19.2 to Conn's, Inc. Form 10-K for the annual period ended January 31, 2006 (File No. 000-50421) as filed with the Securities and Exchange Commission on March 30, 2006).
- 10.19.3 Amendment #3 to Dealer Agreement by and among Conn Appliances, Inc., CAI, L.P., Federal Warranty Service Corporation and Voyager Service Programs, Inc. effective as of July 1, 2005 (incorporated herein by reference to Exhibit 10.19.3 to Conn's, Inc. Form 10-K for the annual period ended January 31, 2006 (File No. 000-50421) as filed with the Securities and Exchange Commission on March 30, 2006).
- 10.19.4 Amendment #4 to Dealer Agreement by and among Conn Appliances, Inc., CAI, L.P., Federal Warranty Service Corporation and Voyager Service Programs, Inc. effective as of July 1, 2005 (incorporated herein by reference to Exhibit 10.19.4 to Conn's, Inc. Form 10-K for the annual period ended January 31, 2006 (File No. 000-50421) as filed with the Securities and Exchange Commission on March 30, 2006).
- 10.20 Service Expense Reimbursement Agreement between Affiliates Insurance Agency, Inc. and American Bankers Life Assurance Company of Florida, American Bankers Insurance Company Ranchers & Farmers County Mutual Insurance Company, Voyager Life Insurance Company and Voyager Property and Casualty Insurance Company effective July 1, 1998 (incorporated herein by reference to Exhibit 10.20 to Conn's, Inc. Form 10-K for the annual period ended January 31, 2006 (File No. 000-50421) as filed with the Securities and Exchange Commission on March 30, 2006).
- 10.20.1 First Amendment to Service Expense Reimbursement Agreement by and among CAI, L.P., Affiliates Insurance Agency, Inc., American Bankers Life Assurance Company of Florida, Voyager Property & Casualty Insurance Company, American Bankers Life Assurance Company of Florida, American Bankers Insurance Company of Florida and American Bankers General Agency, Inc. effective July 1, 2005 (incorporated herein by reference to Exhibit 10.20.1 to Conn's, Inc. Form 10-K for the annual period ended January 31, 2006 (File No. 000-50421) as filed with the Securities and Exchange Commission on March 30, 2006).
- 10.21 Service Expense Reimbursement Agreement between CAI Credit Insurance Agency, Inc. and American Bankers Life Assurance Company of Florida, American Bankers Insurance Company Ranchers & Farmers County Mutual Insurance Company, Voyager Life Insurance Company and Voyager Property and Casualty Insurance Company effective July 1, 1998 (incorporated herein by reference to Exhibit 10.21 to Conn's, Inc. Form 10-K for the annual period ended January 31, 2006 (File No.

Edgar Filing: CONNS INC - Form 10-Q

000-50421) as filed with the Securities and Exchange Commission on March 30, 2006).

- 10.21.1 First Amendment to Service Expense Reimbursement Agreement by and among CAI Credit Insurance Agency, Inc., American Bankers Life Assurance Company of Florida, Voyager Property & Casualty Insurance Company, American Bankers Life Assurance Company of Florida, American Bankers Insurance Company of Florida, American Reliable Insurance Company, and American Bankers General Agency, Inc. effective July 1, 2005 (incorporated herein by reference to Exhibit 10.21.1 to Conn's, Inc. Form 10-K for the annual period ended January 31, 2006 (File No. 000-50421) as filed with the Securities and Exchange Commission on March 30, 2006).
- 42
- 10.22 Consolidated Addendum and Amendment to Service Expense Reimbursement Agreements by and among Certain Member Companies of Assurant Solutions, CAI Credit Insurance Agency, Inc. and Affiliates Insurance Agency, Inc. effective April 1, 2004 (incorporated herein by reference to Exhibit 10.22 to Conn's, Inc. Form 10-K for the annual period ended January 31, 2006 (File No. 000-50421) as filed with the Securities and Exchange Commission on March 30, 2006).
- 10.23 Series 2006-A Supplement to Base Indenture, dated August 1, 2006, by and between Conn Funding II, L.P., as Issuer, and Wells Fargo Bank, National Association, as Trustee (filed herewith).
- 11.1 Statement re: computation of earnings per share is included under Note 1 to the financial statements.
- 21 Subsidiaries of Conn's, Inc. (incorporated herein by reference to Exhibit 21 to Conn's, Inc. registration statement on Form S-1 (file no. 333-109046) as filed with the Securities and Exchange Commission on September 23, 2003).
- 31.1 Rule 13a-14(a)/15d-14(a) Certification (Chief Executive Officer) (filed herewith).
- 31.2 Rule 13a-14(a)/15d-14(a) Certification (Chief Financial Officer) (filed herewith).
- 32.1 Section 1350 Certification (Chief Executive Officer and Chief Financial Officer) (furnished herewith).
- 99.1 Subcertification by Chief Operating Officer in support of Rule 13a-14(a)/15d-14(a) Certification (Chief Executive Officer) (filed herewith).
- 99.2 Subcertification by Treasurer in support of Rule 13a-14(a)/15d-14(a) Certification (Chief Financial Officer) (filed herewith).
- 99.3 Subcertification by Secretary in support of Rule 13a-14(a)/15d-14(a) Certification (Chief Financial Officer) (filed herewith).
- 99.4 Subcertification of Chief Operating Officer, Treasurer and Secretary in support of Section 1350 Certifications (Chief Executive Officer and Chief Financial Officer) (furnished herewith).
- t Management contract or compensatory plan or arrangement.

