

# Conn's, Inc. 2006 Annual Report

Meeting Challenges and Achieving Success



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FINANCIAL

**Conn's**  
SINCE 1890

ELECTRONICS APPLIANCES

MATTRE



# CHAIRMAN'S LETTER

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## On the Cover

Drawing of Conn's new Baytown, Texas store which opened 4/21/06.

April 25, 2006

My Fellow Shareholders:

This past year was characterized by change, challenge, phenomenal growth and higher returns for you our shareholders. While circumstances were often difficult, in retrospect I am very proud of our team's accomplishments for the year.

We began the year with a major realignment of our retail division management which consolidated merchandising, sales, store operations, training and advertising under central leadership. It allowed us to refocus our sales efforts and effectively communicate to all our associates based on the key elements of our sales process even as we added more sales associates in each store. This "back to basics" and "attention to detail" approach was a catalyst in increasing sales growth early in the year. The changes we instituted in the first half of the year would play a major role in meeting more challenges in the second half.

In August, Hurricane Katrina hit the Mississippi Gulf Coast just east of New Orleans, Louisiana, and disrupted electrical and communication service for our stores in Baton Rouge. By using mobile generators and satellite communications we were able to operate our two stores in Baton Rouge and meet the increasing demand brought on by evacuees from New Orleans.

Then in September, Hurricane Rita dealt a direct blow to Beaumont, Texas, the location of our corporate headquarters and home for many of our families. Rita had initially taken a more westward path which resulted in the evacuation of Houston and the surrounding area causing us to close eighteen Houston area stores for two-plus days.

The actual landfall affected Southeast Texas and Southwest Louisiana where we operate five stores, a large distribution center and a service facility. Due to damage, loss of power and loss of city services, these stores were closed for the better part of three weeks.

The greatest impact, however, was the complete evacuation of everyone associated with our corporate headquarter operations. Well in advance of the storm, we had made detailed provision for continuing our operations. Days before the storm hit, sales and Merchandising had moved its operations to Dallas, and our backup computer was installed in Dallas and operating all our main systems. We were prepared.

Southeast Texas was ordered evacuated two days prior

to the storm. When the storm finally came ashore we realized that we would not be able to return home for a considerable time. As our displaced associates found safety and security for their families away from the coast, they began to migrate to Dallas, Houston, San Antonio, and Austin where we were operating our corporate functions. As we devoted much attention to restoring operations in the affected areas, our business elsewhere continued unabated. In two weeks time, we had restored full functionality to our corporate headquarters in Beaumont, most stores in the area were open at least part of each day and the distribution and service centers were operational. We had met the challenge. As residents returned, Conn's was there to meet their needs.

We had phenomenal growth during the year. Product sales grew over 26% and same store sales grew nearly 17%. It began as we started to realize efficiencies with our store initiatives early in the year and grew all year long. It was aided by a robust marketplace energized by technology in electronics and appliances. The "flat-panel" technology really caught-on in the television market as consumers accepted it and falling prices made it more attainable. High-efficiency laundry drove higher average tickets as our skilled, knowledgeable sales associates demonstrated the benefits over



"Spacious stores"

## CHAIRMAN'S LETTER (CONT.)

conventional models. We successfully expanded our furniture line which resulted in a 113% increase in that category. And we met the needs of our customers as they replaced damaged products due to the storms.

And the growth was not only in the top line. Net income increased nearly 37% and higher stock values were realized in the market.

In many ways, though, the facts and figures contained in this report fail to tell the real story of the tireless dedication of our associates as they applied themselves to every task they confronted: management restructuring, two vicious storms, the addition of six new stores, the addition of a major distribution center in Dallas, and record-breaking sales growth. There is definitely a human side to the story. When we say that same store sales grew 17% for the year, men and women made those sales, working diligently to serve our customers' needs. Additionally, merchandisers, warehouse personnel and delivery teams were all impacted, seizing opportunities to render exceptional customer service. When we say that we came through the storms okay, it was due to incredible sacrifice made by so many of our associates, many temporarily relocated hundreds of miles from home in order that we might continue to operate the Company effectively.

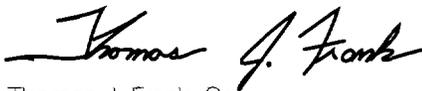
We've met similar challenges before: repeated record sales growth, the IPO in 2003, the Houston floods of 2001, the high interest rates of the late 80's. Never-the-less, I am extremely proud of our team members for all that they have achieved this year. Although their leader, I am just honored to be numbered among them.

And you too share in this human story. You are a part of us. That was never made more clear to me than just after the storms as we began to communicate with many of you again. You inquired about us. Not how had the business done. Not how safe was your investment, but how safe were we and how had we fared personally. Thank you for your continual concern and support, for sharing in our story and for sharing our story with others.

We have met the challenges of the past year and we are sure to face many in the coming year, e.g. continued growth, ever-present competition and difficult comps. I take heart, however, in the accomplishments of the past as we face the future, not out of complacency, but in the knowledge that we have gained even greater experience to address whatever lies before us.

Our people are capable, committed and prepared to meet the challenges.

Sincerely,



Thomas J. Frank, Sr.  
Chairman and CEO



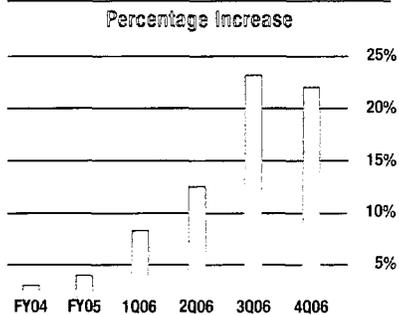
Thomas J. Frank, Sr.  
Chairman/CEO



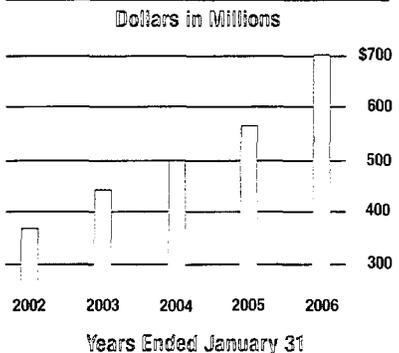
"Incredible selection"



Same Store Sales



Revenues



"Dependable customer service"

Financial Results

Total revenue increased \$135.3 million, or 23.9%, to \$702.4 million for the year ended January 31, 2006. The increase was attributable to increases in Net sales of \$126.5 million, or 25.6%, and \$8.8 million, or 12.1%, in Finance charges and other. The increase in Net sales was made up primarily from same store sales increases of \$75.8 million, or 16.9%, while sales from stores not open a full two years contributed \$49.8 million, service revenues increased \$1.6 million and discounts on promotional credit sales decreased \$644,000. Gross margin decreased from 36.6% in the prior year to 35.5% this year due to faster growth in Net sales than in Finance charges and other. Operating margin increased from 8.6% to 9.1% primarily from reductions in SG&A expenses and provision for bad debts when viewed as a percentage of revenue. Net income rose 36.7% to \$41.2 million. A complete discussion of our financial performance for the year compared to the prior years can be found under the caption "Managements Discussion and Analysis of Financial Condition and Results of Operations" beginning on page 28 of our Annual Report on Form 10-K

Credit Portfolio

Historically, we have financed 57% of our sales through various credit products offered by our own credit division. Although the resulting receivables are sold, generating cash for the Company, Conn's still services the receivables and maintains good relations with our customers which keeps delinquencies and charge-offs low. We employ over 300 employees in the credit division alone to assist our customers with their credit needs. The total portfolio balance increased 21.2% to \$519.7 million during the year ended January 31, 2006. The total number of accounts increased from 350,251 to 415,338, or 18.6% and the average account balance increase from \$1,224 to \$1,251. Accounts delinquent for over 60 days increased 51.3% to \$35.5 million, or 6.8% of the portfolio balance. The increase in delinquencies is directly

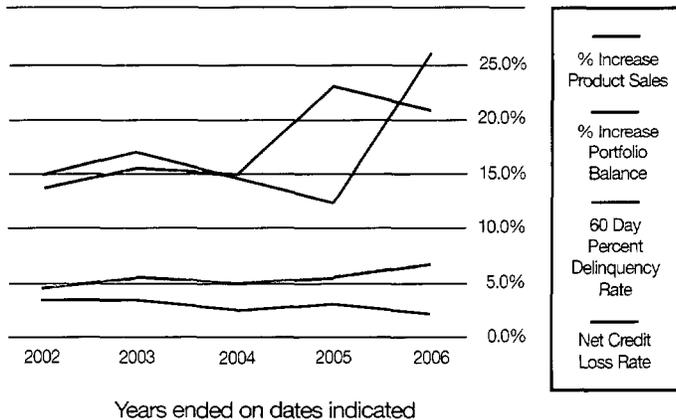
related to accounts within the geographic area affected by Hurricanes Katrina and Rita in the fiscal third quarter. Additional provision for bad debts was recorded in the third quarter in anticipation of higher charge-offs due to these delinquencies. It is the Company's belief that higher delinquencies and charge-offs, if any, will be temporary in nature and that the long term trends characterized by this portfolio will be sustained. Charge-offs as a percentage of the portfolio decreased from 2.9% to 2.5%.

Capital Expenditures

We spent \$18.5 million on capital projects during the fiscal year, mostly for new stores and updates to exist-

ing stores. We opened six new stores: one in San Antonio, one in South Texas, and four in Dallas. We also opened a new 150,000 square foot distribution center in Carrollton, Texas, to serve the Dallas/Fort Worth market. We also expanded our service facility in that market.

Combined Portfolio Statistics



## OPERATIONAL REVIEW (CONT.)

We expect to add six to eight new stores in the next fiscal year, many of them in markets where we already have a presence and the considerable infrastructure necessary to support our stores and our customers. We operate a fleet of our own delivery and service vehicles as part of our customer service initiatives and a portion of our capital expenditures is used to continually update this fleet with new vehicles.

### Customer Focus

In all that we do as a company, we constantly focus on satisfying our customers. In each and every aspect of our business we are granted opportunities to render personal service to individuals who visit our stores, make a purchase, finance their purchase, take advantage of our delivery and installation, or experience a service problem. We remain focused on superior execution of each function to maximize the impact on a positive customer experience. It is that positive experience that we believe drives future sales.

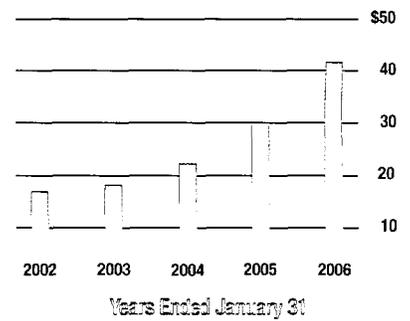
### Management Changes

The Board of Directors, during its March 28<sup>th</sup> meeting, promoted William C. Nylin, Jr. to Executive Vice Chairman of the Board. Nylin, formerly President, will continue to serve as the company's Chief Operating Officer. The Board also promoted Tim L. Frank to President and David W. Trahan to Senior Vice President of Retail. Earlier in 2005, Robert B. Lee, Jr. was appointed Senior Vice President of Service and Logistics. Such changes allow the Company to continue to develop the skills of its executive team and to provide the leadership for the Company's continued growth.

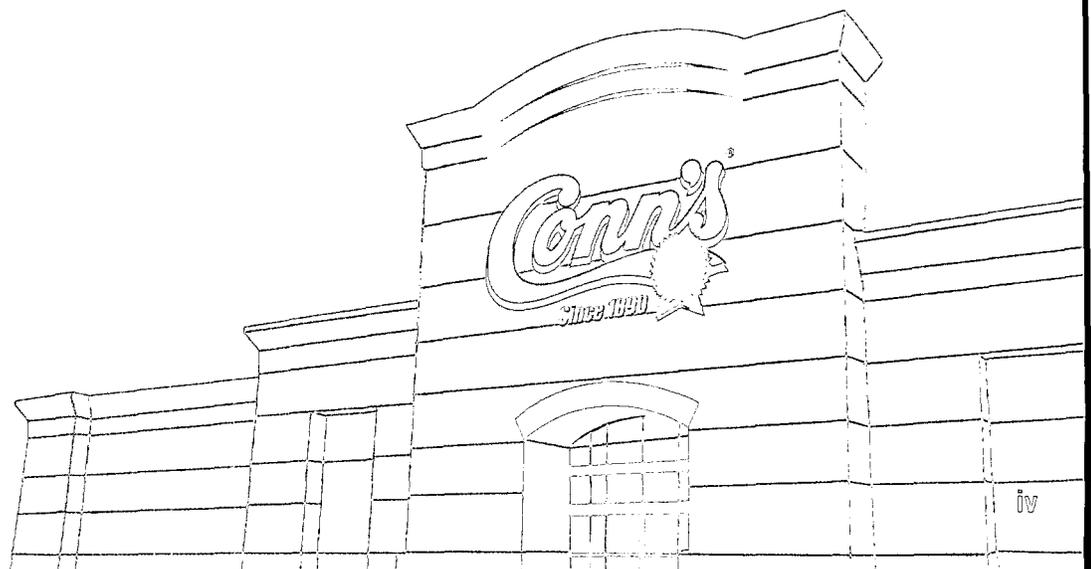
Merchandising, Credit, Distribution, Service  
and Training **DRIVE** Sales

### Net Income

Dollars in Millions



"Outstanding customer relations"



# BOARD OF DIRECTORS



Thomas J. Frank, Sr.  
Chairman/CEO  
Age: 66  
Member Since 1980



William C. Nylín, Jr.  
Executive Vice  
Chairman/COO  
Age: 63  
Member Since 2006



Marvin D. Brailsford  
Director  
Age: 67  
Member Since 2003



Theodore M. Wright  
Director  
Age: 43  
Member Since 2003



Jon E. M. Jacoby  
Director  
Age: 68  
Member Since 2003



Scott L. Thompson  
Director  
Age: 47  
Member Since 2003



William T. Trawick  
Director  
Age: 59  
Member Since 2003



Bob L. Martin  
Director  
Age: 57  
Member Since 2003



Douglas H. Martin  
Director  
Age: 52  
Member Since 1998

# MANAGEMENT TEAM



Tom Frank  
Chairman/CEO  
Age: 66  
Years of Service: 46



Bill Nylm  
Executive Vice  
Chairman/COO  
Age: 63  
Years of Service: 13

Corporate Office  
3295 College Street  
Beaumont, Texas 77701

Common Stock Listing  
NASDAQ National Market  
Symbol: CONN

Transfer Agent and Registrar  
Computershare  
Canton, Massachusetts

Independent Accountants  
Ernst & Young, LLP  
Houston, Texas

Annual Meeting  
May 31, 2006  
10:00 AM



Tim Frank  
President  
Age: 38  
Years of Service: 10



David Rogers  
CFO  
Age: 57  
Years of Service: 9



David Atnip  
Sr. VP/Treasurer  
Age: 58  
Years of Service: 13



David Trahan  
Sr. VP - Retail  
Age: 45  
Years of Service: 20



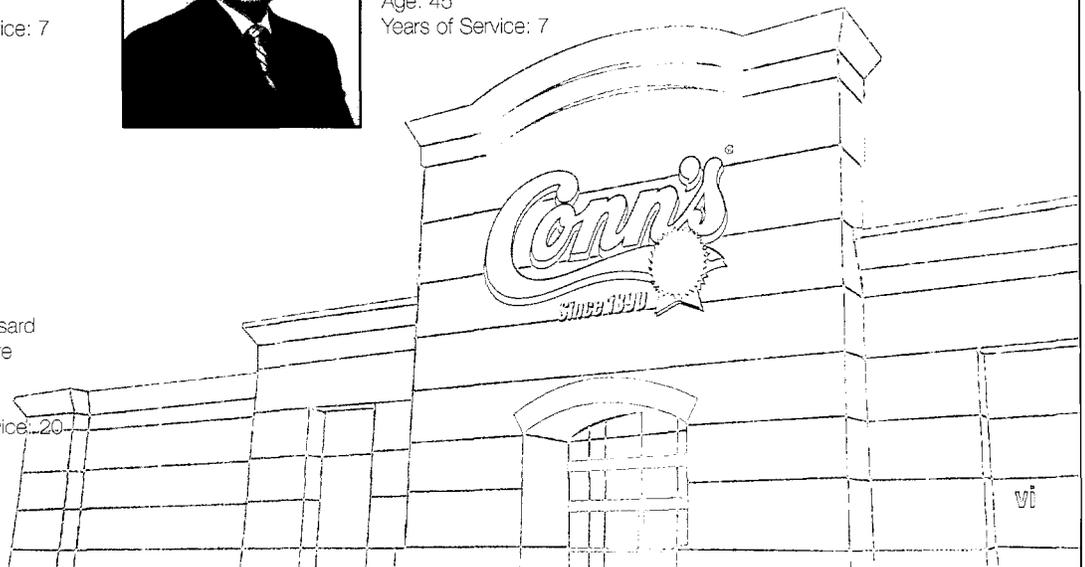
Bob Lee  
Sr. VP - Service  
& Logistics  
Age: 58  
Years of Service: 7



Rey de la Fuente, Jr.  
Sr. VP - Conn's  
President - Conn Credit Corp.  
Age: 45  
Years of Service: 7



Walter Broussard  
Sr. VP - Store  
Operations  
Age: 46  
Years of Service: 20



## Financial Highlights

	Year Ended July 31, 2001	Six Months Ended January 31, 2002	Twelve Months Ended January 31, 2002 (unaudited)	Years Ended January 31,			
				2003	2004	2005	2006
Statement of Operations (1): (dollars and shares in thousands, except per share amounts)							
Total revenues	\$327,257	\$206,896	\$378,525	\$445,973	\$499,310	\$567,092	\$702,422
Operating expense:							
Cost of goods sold, including warehousing and occupancy cost	201,963	127,543	233,226	276,956	317,712	359,710	453,374
Selling, general and administrative expense	92,194	58,630	106,949	125,712	135,174	152,900	181,631
Provision for bad debts	1,734	1,286	2,406	4,125	4,657	5,637	3,769
Total operating expense	295,891	187,459	342,581	406,793	457,543	518,247	638,774
Operating income	31,366	19,437	35,944	39,180	41,767	48,845	63,648
Interest expense, net and minority interest	3,754	2,940	4,855	7,237	4,577	2,477	400
Earnings before income taxes	27,612	16,497	31,089	31,943	37,190	46,368	63,248
Provision for income taxes	9,879	5,944	11,130	11,342	12,850	16,243	22,067
Net income from continuing operations	17,733	10,553	19,959	20,601	24,340	30,125	41,181
Discontinued operations, net of tax	(546)	-	(389)	-	-	-	-
Net income	17,187	10,553	19,570	20,601	24,340	30,125	41,181
Less preferred stock dividends (2)	(2,173)	(1,025)	(1,939)	(2,133)	(1,954)	-	-
Net income available for common stockholders	\$15,014	\$9,528	\$17,631	\$18,468	\$22,386	\$30,125	\$41,181
Earnings per common share:							
Basic	\$0.87	\$0.56	\$1.03	\$1.10	\$1.26	\$1.30	\$1.76
Diluted	\$0.87	\$0.55	\$1.01	\$1.10	\$1.22	\$1.27	\$1.70
Average common shares outstanding:							
Basic	17,169	17,025	17,060	16,724	17,726	23,192	23,411
Diluted	17,194	17,327	17,383	16,724	18,335	23,754	24,192
<b>Other Financial Data:</b>							
Stores open at end of period	32	36	36	42	45	50	56
Same store sales growth (3)	10.3%	16.7%	15.6%	1.3%	2.6%	3.6%	16.9%
Inventory turns (4)	5.9	7.5	6.8	6.6	6.5	6.0	6.5
Gross margin percentage (5)	38.3%	38.4%	38.4%	37.9%	36.4%	36.6%	35.5%
Operating margin (6)	9.6%	9.4%	9.5%	8.8%	8.4%	8.6%	9.1%
Return on average equity (7)	36.7%	35.9%	34.9%	28.3%	19.5%	16.4%	18.5%
Capital expenditures	\$14,833	\$10,551	\$15,547	\$15,070	\$9,401	\$19,619	\$18,490
<b>Balance Sheet Data:</b>							
Working capital	\$40,752	\$45,546	\$45,546	\$69,984	\$115,366	\$148,074	\$179,496
Total assets	134,425	145,644	145,644	181,798	234,760	268,003	339,984
Total debt	31,445	38,750	38,750	51,992	14,512	10,532	136
Preferred stock	15,400	15,226	15,226	15,226	-	-	-
Total stockholders' equity	54,879	62,860	62,860	82,669	166,590	200,802	245,284

(1) Information excludes the operations of the rent-to-own division that was sold in February, 2001.

(2) Dividends were not actually declared or paid until 2004, but are presented for purposes of earnings per share calculations.

(3) 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 period. Sales from closed stores have been removed from each period. Sales from relocated stores have been included in each period because each such store was relocated within the same general geographic market. Sales from expanded stores have been included in each period.

(4) Inventory turns are defined as the cost of goods sold, excluding warehousing and occupancy cost, divided by the average of the beginning and ending product inventory; information for the six months ended January 31, 2002 has been annualized for comparison purposes.

(5) Gross margin percentage is defined as total revenues less cost of goods and parts sold, including warehousing and occupancy cost, divided by total revenues.

(6) Operating margin is defined as operating income divided by total revenues.

(7) Return on average equity is calculated as current period net income from continuing operations divided by the average of the beginning and ending equity; information for the six months ended January 31, 2002 has been annualized for comparison purposes.

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

Form 10-K

Annual Report Pursuant to Section 13 or 15(d)  
of the Securities Exchange Act of 1934

For the fiscal year ended January 31, 2006

Commission File Number 000-50421

**CONN'S, INC.**

(Exact Name of Registrant as Specified in its Charter)

**A Delaware Corporation**

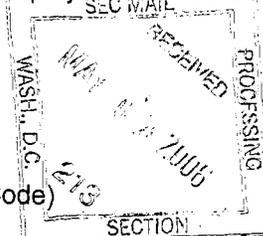
(State or other jurisdiction of incorporation or organization)

**06-1672840**

(I.R.S. Employer Identification Number)

**3295 College Street  
Beaumont, Texas 77701**  
(Address of Principal Executive Offices)

**(409) 832-1696**  
(Registrant's Telephone Number, Including Area Code)



Securities registered pursuant to Section 12(b) of the Act:

**NONE**

Securities registered pursuant to Section 12(g) of the Act:

Title of Class

**Common Stock, Par Value \$0.01 Per Share**

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

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

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates as of July 29, 2005 was approximately \$180,604,464 based on the closing price of the registrant's common stock as reported on the NASDAQ National Market.

There were 23,571,564 shares of common stock, \$0.01 par value per share, outstanding on March 27, 2006.

**DOCUMENTS INCORPORATED BY REFERENCE:**

Portions of the Definitive Proxy Statement for the Annual Meeting of Stockholders to be held May 31, 2006 (incorporated herein by reference in Part III).

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## PART I

### ITEM 1. BUSINESS.

*Unless the context indicates otherwise, references to "we," "us," and "our" refer to the consolidated business operations of Conn's, Inc. and all of its direct and indirect subsidiaries, limited liability companies and limited partnerships.*

#### Overview

We are a specialty retailer of home appliances and consumer electronics. We sell major home appliances including refrigerators, freezers, washers, dryers and ranges, and a variety of consumer electronics including projection, plasma and LCD televisions, camcorders, DVD players and home theater products. We also sell home office equipment, lawn and garden equipment, mattresses and furniture and we continue to introduce additional product categories for the home and for consumer entertainment, such as MP3's, to help increase same store sales and to respond to our customers' product needs. We offer over 1,100 product items, or SKUs, at good-better-best price points representing such national brands as General Electric, Whirlpool, Frigidaire, Maytag, LG, Mitsubishi, Samsung, Sony, Toshiba, Serta, Hewlett Packard and Compaq. Based on revenue in 2004, we were the 12<sup>th</sup> largest retailer of home appliances in the United States. Additionally, historically we are the second or third leading retailer of home appliances in terms of market share in the majority of our established markets. Likewise, in the home entertainment product categories in which we compete, we rank third or fourth in market share in the majority of our established markets.

We began as a small plumbing and heating business in 1890. We began selling home appliances to the retail market in 1937 through one store located in Beaumont, Texas. We opened our second store in 1959 and have since grown to 56 stores.

We have been known for providing excellent customer service for over 115 years. We believe that our customer-focused business strategies make us an attractive alternative to appliance and electronics superstores, department stores and other national, regional and local retailers. We strive to provide our customers with:

- a high level of customer service;
- highly trained and knowledgeable sales personnel;
- a broad range of competitively priced, customer-driven, brand name products;
- flexible financing alternatives through our proprietary credit programs;
- same day and next day delivery capabilities; and
- outstanding product repair service.

We believe that these strategies drive repeat purchases and enable us to generate substantial brand name recognition and customer loyalty. During fiscal 2006, approximately 62% of our credit customers, based on the number of invoices written, were repeat customers.

In 1994, we realigned and added to our management team, enhanced our infrastructure and refined our operating strategy to position ourselves for future growth. From fiscal 1994 to fiscal 1999, we selectively grew our store base from 21 to 26 stores while improving operating margins from 5.2% to 8.7%. Since fiscal 1999, we have generated significant growth in our number of stores, revenue and profitability. Specifically:

- we have grown from 26 stores to 56 stores, an increase of over 115%, with several more stores currently under development;
- total revenues have grown by 200% at a compounded annual rate of 17.0% from \$234.5 million in fiscal 1999, to \$702.4 million in fiscal 2006;

- net income from continuing operations has grown by 360% at a compounded annual rate of 24.7% from \$8.8 million in fiscal 1999 to \$41.2 million in fiscal 2006; and
- our same store sales growth from fiscal 1999 through fiscal 2006 has averaged 9.2%; it was 16.9% for fiscal 2006. See additional discussion about same store sales under Managements Discussion and Analysis of Financial Condition and Results of Operations.

Our principal executives offices are located at 3295 College Street, Beaumont, Texas 77701. Our telephone number is (409) 832-1696, and our corporate website is [www.conns.com](http://www.conns.com). We do not intend for information contained on our website to be part of this Form 10-K.

## Corporate Reorganization

We were formed as a Delaware corporation in January 2003 with an initial capitalization of \$1,000 to become the holding company of Conn Appliances, Inc., a Texas corporation. Prior to the completion of our initial public offering (the "IPO") in November 2003, we had no operations. As a result of the IPO, Conn Appliances, Inc. became our wholly-owned subsidiary and the common and preferred stockholders of Conn Appliances, Inc. exchanged their common and preferred stock on a one-for-one basis for the common and preferred stock of Conn's, Inc. Immediately after the IPO, all preferred stock and accumulated dividends were redeemed, either through the payment of cash or through the conversion of preferred stock to common stock.

## Industry Overview

The home appliance and consumer electronics industry includes major home appliances, small appliances, home office equipment and software, projection, plasma and LCD televisions, and audio, video and portable electronics. Sellers of home appliances and consumer electronics include large appliance and electronics superstores, national chains, small regional chains, single-store operators, appliance and consumer electronics departments of selected department and discount stores and home improvement centers.

Based on data published in *Twice, This Week in Consumer Electronics*, a weekly magazine dedicated to the home appliances and consumer electronics industry in the United States, the top 100 major appliance retailers reported sales of approximately \$22.1 billion in 2004, up approximately 10.0% from reported sales in 2003 of approximately \$20.1 billion. The retail appliance market is large and concentrated among a few major dealers. Sears has been the leader in the retail appliance market, with a market share of the top 100 retailers of approximately 39% in 2004, down from approximately 42% in 2003. Lowe's and Home Depot held the second and third place positions, respectively, in national market share in 2004.

As measured by *Twice*, the top 100 consumer electronics retailers in the United States reported equipment and software sales of \$96.7 billion in 2004, a 7.9% increase from the \$89.6 billion reported in 2003. According to the Consumer Electronics Association, or CEA, total industry manufacturer sales of consumer electronics products in the United States, including imports, are projected to exceed \$109 billion by 2007. The consumer electronics market is highly fragmented. We estimate, based on data provided in *Twice*, that the two largest consumer electronics superstore chains together accounted for less than 28% of the total electronics sales attributable to the 100 largest retailers in 2004. New entrants in both the home appliances and consumer electronics industries have been successful in gaining market share by offering similar product selections at lower prices.

In the home appliance market, many factors drive growth, including consumer confidence, household formations and new product introductions. Product design and innovation is rapidly becoming a key driver of growth in this market. Products either recently reintroduced or scheduled to be offered include high efficiency, front-loading laundry appliances, three door refrigerators, double ovens, free-standing ranges, cabinet style dishwashers, and dual fuel cooking appliances.

Technological advancements and the introduction of new products have largely driven growth in the consumer electronics market. Recently, industry growth has been fueled primarily by the introduction of products that incorporate digital technology, such as portable and traditional DVD players, digital cameras and camcorders, digital stereo receivers, satellite technology, MP3 products and high definition flat panel and projection televisions. Digital products offer significant advantages over their analog counterparts, including better clarity and quality of video and audio, durability of recording and compatibility with computers. Due to

these advantages, we believe that digital technology will continue to drive industry growth as consumers replace their analog products with digital products. We believe the following product advancements will continue to fuel growth in the consumer electronics industry and that they offer us the potential for significant sales growth:

- **Digital Television (DTV and High Definition TV).** The Federal Communications Commission has set a hard date of February 17, 2009 for all commercial television stations to transition from broadcasting analog signals to digital signals. The Yankee Group, a communications and networking research and consulting firm, estimates that by the year 2007, HDTV signals will be in nearly 41.6 million, or 40%, of homes in the United States. This represents a compounded annual growth rate of 17.1% from the estimated 18.9 million homes receiving digital cable at the end of 2002. To view a digital transmission, consumers will need either a digital television or a set-top box converter capable of converting the digital broadcast for viewing on an analog set. According to the CEA, DTV unit sales are expected to grow from 12.0 million units in 2005 to 15.8 million units in 2006, representing an annual growth rate of 32.5%. We believe the high clarity digital flat panel televisions in both liquid crystal display (LCD), and plasma formats has increased the quality and sophistication of these entertainment products and will be a key driver of digital television growth as more digital and high definition content is made available either through traditional distribution methods or through emerging content delivery systems. As prices continue to drop on such products, they become increasingly attractive to larger and more diverse group of consumers.
- **Digital Versatile Disc (DVD).** According to the CEA, the DVD player has become the fastest growing consumer electronics product in history. First introduced in March 1997, DVD players are currently in 80% of U.S. homes. We believe newer technology based on the DVD delivery system, such as high definition DVD, "blu-ray", and portable players will continue to drive consumer interest in this entertainment category.
- **Portable electronics.** Compressed-music portables, represented most notably by the Apple "iPod", enjoy significant growth, and accounted for 84.5% of total dollar sales in battery-operated music portables in 2005 according to the CEA as reported in TWICE magazine. Apple shipped more than 14 million units of the iPod in the quarter ended December 31, 2005 as compared to 4.6 million in the prior year period.

## **Business Strategy**

Our objective is to be the leading specialty retailer of home appliances and consumer electronics in each of our markets. We strive to achieve this objective through a continuing focus on superior execution in five key areas: merchandising, consumer credit, distribution, product service and training. Successful execution in each area relies on the following strategies:

- **Providing a high level of customer service.** We endeavor to maintain a very high level of customer service as a key component of our culture, which has resulted in average customer satisfaction levels of approximately 91% over the past three years. We measure customer satisfaction on the sales floor, in our delivery operation and in our service department by sending survey cards to all customers to whom we have delivered or installed a product or made a service call. Our customer service resolution department attempts to address all customer complaints within 48 hours of receipt.
- **Developing and retaining highly trained and knowledgeable sales personnel.** We require all sales personnel to specialize in home appliances, consumer electronics or "track" products. Some of our sales associates qualify in more than one specialty. Track products include small appliances, computers, camcorders, DVD players, cameras, MP3 players and telephones that are sold within the interior of a large colorful track that circles the interior floor of our stores. This specialized approach allows the sales person to focus on specific product categories and become an expert in selling and using products in those categories. New sales personnel must complete an intensive two-week classroom training program conducted at our corporate office and an additional week of on-the-job training riding in a delivery and a service truck to observe how we serve our customers after the sale is made.
- **Offering a broad range of customer-driven, brand name products.** We offer a comprehensive selection of high-quality, brand name merchandise to our customers at guaranteed low prices. Consistent with our good-better-best merchandising strategy, we offer a wide range of product

selections from entry-level models through high-end models. We maintain strong relationships with approximately 50 manufacturers and distributors that enable us to offer over 1,100 SKUs to our customers. Our principal suppliers include General Electric, Whirlpool, Frigidaire, Maytag, LG, Mitsubishi, Samsung, Sony, Toshiba, Serta, Poulan, Weedeater, American Yard Products, Hewlett Packard and Compaq. To facilitate our responsiveness to customer demand, we use our prototype store, located near our corporate offices in Beaumont, Texas, to test the sales process of all new products and obtain customers' reactions to new display formats before introducing these products and display formats to our other stores.

- **Offering flexible financing alternatives through our proprietary credit programs.** In the last three years, we financed, on average, approximately 57% of our retail sales through our internal credit programs. We believe our credit programs expand our potential customer base, increase our sales revenue and enhance customer loyalty by providing our customers immediate access to financing alternatives that our competitors typically do not offer. Our credit department makes all credit decisions internally, entirely independent of our sales personnel. We provide special consideration to the customer's credit history with us. Before extending credit, we match our loss experience by product category with the customer's credit worthiness to determine down payment amounts and other credit terms. This facilitates product sales while keeping our credit risk within an acceptable range. Approximately 58% of customers who have active credit accounts with us take advantage of our in-store payment option and come to our stores each month to make their payments, which we believe results in additional sales to these customers. Through our predictive dialing program, we contact customers with past due accounts daily and attempt to work with them to collect payments in times of financial difficulty or periods of economic downturn. Our credit decisions and collections process enabled us to achieve a 2.9% net loss ratio in fiscal 2004, a 2.4% net loss ratio in fiscal 2005 and a 2.5% net loss ratio in fiscal 2006 on the credit portfolio that we service for a Qualifying Special Purpose Entity or QSPE.
- **Maintaining same day and next day distribution capabilities.** We maintain four regional distribution centers and three other related facilities that cover all of the major markets in which we operate. These facilities are part of a sophisticated inventory management system that also includes a fleet of approximately 130 transfer and delivery vehicles that service all of our markets. Our distribution operations enable us to deliver products on the day of, or the day after, the sale to approximately 95% of our customers.
- **Providing outstanding product repair service.** We service every product that we sell, and we service only the products that we sell. In this way, we can assure our customers that they will receive our service technicians' exclusive attention to their product repair needs. All of our service centers are authorized factory service facilities that provide trained technicians to offer in-home diagnostic and repair service as well as on-site service and repairs for products that cannot be repaired in the customer's home.

### **Store Development and Growth Strategy**

In addition to executing our business strategy, we intend to continue to achieve profitable, controlled growth by increasing same store sales, opening new stores and updating, expanding or relocating our existing stores.

- **Increasing same store sales.** We plan to continue to increase our same store sales by:
  - continuing to offer quality products at competitive prices;
  - re-merchandising our product offerings in response to changes in consumer demand;
  - adding new merchandise to our existing product lines;
  - training our sales personnel to increase sales closing rates;
  - updating our stores on a three-year rotating basis;
  - continuing to promote sales of computers and smaller electronics within the interior track area of

our stores, including the expansion of high margin accessory items;

- continuing to provide a high level of customer service in sales, delivery and servicing of our products; and
- increasing sales of our merchandise, finance products, service maintenance agreements and credit insurance through direct mail and in-store credit promotion programs.
- **Opening new stores.** We intend to take advantage of our reliable infrastructure and proven store model to continue the pace of our new store openings by opening six to eight new stores in fiscal 2007. This infrastructure includes our proprietary management information systems, training processes, distribution network, merchandising capabilities, supplier relationships and centralized credit approval and collection processes. We intend to expand our store base in existing, adjacent and new markets, as follows:
  - *Existing and adjacent markets.* We intend to increase our market presence by opening new stores in our existing markets, in adjacent markets and in new markets as we identify the need and opportunity. New store openings in these locations will allow us to maximize opportunity in those markets and leverage our existing distribution network, advertising presence, brand name recognition and reputation.
  - *New markets.* In fiscal 2006, we opened another new store in South Texas in Harlingen and continued to open new stores in our Dallas/Fort Worth and San Antonio markets. We have identified several new markets that meet our criteria for site selection, including East Texas and central Louisiana around Shreveport, Monroe and Alexandria, southern Oklahoma and southwest Arkansas. We intend to consider these new markets, as well as others, over the next several fiscal years. We intend to first address markets in states in which we currently operate. We expect that this new store growth will include major metropolitan markets in both Texas and Louisiana. We have also identified a number of smaller markets within Texas and Louisiana in which we expect to explore new store opportunities. Our long-term growth plans include markets in other areas of significant population density within neighboring states.
- **Updating, expanding or relocating existing stores.** Over the last three years, we have updated, expanded or relocated most of our stores. We have implemented our larger prototype store model at all locations at which the market demands support such store size, and where available physical space would accommodate the required design changes. As we continue to add new stores or replace existing stores, we intend to modify our floor plan to include this new model as we perceive market support. We continuously evaluate our existing and potential sites to ensure our stores are in the best possible locations and relocate stores that are not properly positioned. We typically lease rather than purchase our stores to retain the flexibility of subleasing a location if we later decide that the store is performing below our standards or the market would be better served by a relocation. After updating, expanding or relocating a store, we expect to increase same store sales at those stores.

The addition of new stores has played, and we believe will continue to play, a significant role in our continued growth and success. We currently operate 56 retail stores located in Texas and Louisiana. We opened three stores in fiscal 2004; and we opened six stores in each of fiscal 2005 and fiscal 2006. We also closed one clearance store in one of our markets in fiscal 2005. We plan to continue our store development program by opening an additional six to eight new stores, or an approximately 10% increase, per year and continue to update a portion of our existing stores each year. We believe that continuing our strategies of updating existing stores, growing our store base and locating our stores in desirable geographic markets are essential for our future success.

## Customers

We do not have a significant concentration of sales with any individual customer and, therefore, the loss of any one customer would not have a material impact on our business. No single customer accounts for more than 10% of our total revenues; in fact, no single customer accounted for more than \$500,000 (less than 0.1%) of our total revenue of \$702.4 million during the year ended January 31, 2006.

## Products and Merchandising

**Product Categories.** Each of our stores sells five major categories of products: major home appliances, consumer electronics, computers and peripheral equipment, delivery and installation services and other household products, including lawn and garden equipment and mattresses. The following table, which has been adjusted from previous filings to ensure comparability, presents a summary of net sales by major product category, service maintenance agreement commissions and service revenues, for the years ended January 31, 2004, 2005, and 2006:

	Years Ended January 31,					
	2004		2005		2006	
	Amount	%	Amount	%	Amount	%
	(dollars in thousands)					
Major home appliances.....	\$ 159,401	36.2%	\$ 168,962	34.2%	\$ 223,651	36.0%
Consumer electronics.....	139,417	31.6	154,880	31.3	186,679	30.1
Track.....	70,031	15.9	85,644	17.3	100,154	16.1
Delivery.....	6,726	1.5	7,605	1.5	9,870	1.6
Lawn and garden.....	11,505	2.6	13,710	2.8	17,083	2.8
Bedding.....	6,441	1.5	10,262	2.1	13,126	2.1
Furniture.....	5,712	1.3	7,182	1.5	15,313	2.5
Other.....	3,346	0.8	3,315	0.7	4,001	0.6
Total product sales.....	402,579	91.3	451,560	91.4	569,877	91.8
Service maintenance agreement commissions.....	20,074	4.6	23,950	4.8	30,583	4.9
Service revenues.....	18,265	4.1	18,725	3.8	20,278	3.3
Total net sales.....	\$ 440,918	100.0%	\$ 494,235	100.0%	\$ 620,738	100.0%

Within these major product categories (excluding service maintenance agreements, service revenues and delivery and installation), we offer our customers over 1,100 SKUs in a wide range of price points. Most of these products are manufactured by brand name companies, including General Electric, Whirlpool, Frigidaire, Maytag, LG, Mitsubishi, Samsung, Sony, Hitachi, Toshiba, Serta, Hewlett Packard and Compaq. As part of our good-better-best merchandising strategy, our customers are able to choose from products ranging from low-end to mid- to high-end models in each of our key product categories, as follows:

Category	Products	Selected Brands
Major appliances	Refrigerators, freezers, washers, dryers, ranges, dishwashers, air conditioners and vacuum cleaners	General Electric, Frigidaire, Whirlpool, Maytag, LG, KitchenAid, Sharp, Samsung, Friedrich, Roper, Hoover and Eureka
Consumer electronics	Projection, plasma, LCD and DLP televisions, and home theater systems	Mitsubishi, Sony, Toshiba, Samsung, Sanyo, JVC, Hitachi, Yamaha, Apple and Fujifilm
Track	Computers, computer peripherals, VCRs, camcorders, digital cameras, DVD players, audio components, compact disc players, speakers and portable electronics (e.g. iPods)	Hewlett Packard, Compaq, Sony
Other	Lawn and garden, furniture and mattresses	Poulan, Husqvarna, Toro, Weedeater, Ashley and Serta

**Purchasing.** We purchase products from over 100 manufacturers and distributors. Our agreements with these manufacturers and distributors typically cover a one or two year time period, are renewable at the option of the parties and are terminable upon 30 days written notice by either party. Similar to other specialty retailers, we purchase a significant portion of our total inventory from a limited number of vendors. During fiscal 2006, 60.6% of our total inventory purchases were from six vendors, including 17.0%, 12.2% and 11.4% of our total inventory from Frigidaire, Whirlpool and Sony respectively. The loss of any one or more of these key vendors or our failure to establish and maintain relationships with these and other vendors could have a material adverse effect on our results of operations and financial condition. We have no indication that any of our suppliers will discontinue selling us merchandise. We have not experienced significant difficulty in maintaining adequate sources of merchandise, and we generally expect that adequate sources of merchandise will continue to exist for the types of products we sell.

**Merchandising Strategy.** We focus on providing a comprehensive selection of high-quality merchandise to appeal to a broad range of potential customers. Consistent with our good-better-best merchandising strategy, we offer a wide range of product selections from entry-level models through high-end models. We primarily sell brand name warranted merchandise. Our established relationships with major appliance and electronic vendors and our affiliation with NATM, a major buying group, give us purchasing power that allows us to offer custom-featured appliances and electronics and provides us a competitive selling advantage over other independent retailers. We use our prototype store, located near our corporate offices in Beaumont, Texas, to test the sale of all new products and obtain customers' reactions to new display formats before introducing these products and display formats to our other stores. As part of our merchandising strategy, we operate clearance centers, either as stand-alone units or incorporated within one of our retail stores, in our Houston, San Antonio and Dallas markets to help sell damaged, used or discontinued merchandise. We have recently redesigned our approach to the merchandising of our "track" products to provide consumer-friendly point of sale transactions that take place within a track area located in the interior of our store. We believe that this focused approach to creating consumer awareness and ease of purchase of our track products will help increase same store sales.

**Pricing.** We emphasize competitive pricing on all of our products and maintain a low price guarantee that is valid in all markets from 10 to 30 days after the sale, depending on the product. At most of our stores, to print an invoice that contains pricing other than the price maintained within our computer system, sales personnel must call a special "hotline" number at the corporate office for approval. Personnel staffing this hotline number are familiar with competitor pricing and are authorized to make price adjustments to fulfill our low price guarantee when a customer presents acceptable proof of the competitor's lower price. This centralized function also allows us to maintain control of pricing and to store and retrieve pricing data of our competitors.

### **Customer Service**

We focus on customer service as a key component of our strategy. We believe our same day or next day delivery option, which is not offered by most of our competitors, is one of the keys to our success. Additionally, we attempt to answer and resolve all customer complaints within 48 hours of receipt. We track customer complaints by individual salesperson, delivery person and service technician. We send out over 36,000 customer satisfaction survey cards each month covering all deliveries and service calls. Based upon a response rate from our customers of approximately 15%, we consistently report an average customer satisfaction level of approximately 91%.

## Store Operations

**Stores.** At the end of fiscal 2006 we operated 56 retail and clearance stores located in Texas and Louisiana. The following table illustrates our markets, the number of freestanding and strip mall stores in each market and the calendar year in which we opened our first store in each market:

Market	Number of Stores		First Store Opened
	Stand Alone	Strip Mall	
Houston .....	8	10	1983
San Antonio/Austin .....	6	7	1994
Golden Triangle (Beaumont, Port Arthur and Orange, Texas and Lake Charles, Louisiana) .....	1	4	1937
Baton Rouge/Lafayette .....	1	4	1975
Corpus Christi .....	1	0	2002
Dallas/Fort Worth .....	1	11	2003
South Texas .....	1	1	2004
Total .....	19	37	

Our stores have an average selling space of approximately 21,100 square feet, plus a rear storage area averaging approximately 6,000 square feet for fast-moving or smaller products that customers prefer to carry out rather than wait for in-home delivery. Two of our stores are clearance centers for discontinued product models and damaged merchandise, returns and repossessed product located in our Houston and Dallas markets and contain 28,800 square feet of combined selling space. All stores are open from 10:00 a.m. to 9:00 p.m. Monday through Friday, from 9:00 a.m. to 9:00 p.m. on Saturday, and from 11:00 a.m. to 7:00 p.m. on Sunday. We also offer extended store hours during the holiday selling season.

Approximately 66% of our stores are located in strip shopping centers and regional malls, with the balance being stand-alone buildings in "power centers" of big box consumer retail stores. All of our locations have parking available immediately adjacent to the store's front entrance. Our storefronts have a distinctive front that guides the customer to the entrance of the store. Inside the store, a large colorful tile track circles the interior floor of the store. One side of the track leads the customer to major appliances, while the other side of the track leads the customer to a large display of television and projection television products. The inside of the track contains various home office and consumer electronic products such as computers, printers, DVD players, camcorders, digital cameras and MP3 players. We are continually refining our approach to merchandising of our track products, and in fiscal 2006 expanded our small kitchen appliance assortment, introduced musical products and expanded our offering of seasonal products. Mattresses, furniture and lawn and garden equipment displays occupy the rear of the sales floor. To reach the cashier's desk at the center of the track area, our customers must walk past our products. We believe this increases sales to customers who have purchased products from us on credit in the past and who return to our stores to make their monthly credit payments.

We have updated most of our stores in the last three years. We expect to continue to update our stores as needed to address each store's specific needs. All of our updated stores, as well as our new stores, include modern interior selling spaces featuring attractive signage and display areas specifically designed for each major product type. Our prototype store for future expansion has from 25,000 to 30,000 square feet of retail selling space, which is approximately 20% more than the average size of our existing stores and a rear storage area of between 5,000 and 7,000 square feet. Our investment to update a store has averaged approximately \$220,000 per store over the past three years, and as a result of the updating, we expect to increase same store sales at those stores. Over the last three years, we have invested approximately \$7.8 million updating, refurbishing or relocating our existing stores.

**Site Selection.** Our stores are typically located adjacent to freeways or major travel arteries and in the vicinity of major retail shopping areas. We prefer to locate our stores in areas where our prominent tower storefront will be the anchor of the shopping center or readily visible from major thoroughfares. We also attempt to locate our stores in the vicinity of major home appliance and electronics superstores. We have typically entered major metropolitan markets where we can potentially support at least 10 to 12 stores. We believe this number of stores allows us to optimize advertising and distribution costs. We have and may continue, however, to elect to experiment with opening lower numbers of new stores in smaller communities where customer

demand for products and services outweighs any extra cost. Other factors we consider when evaluating potential markets include the distance from our distribution centers, our existing store locations and store locations of our competitors and population, demographics and growth potential of the market.

**Store Economics.** We lease 50 of our 56 current store locations, with an average monthly rent of \$18,800. Our average per store investment for the 12 new stores we have opened in the last two years was approximately \$1.5 million, including leasehold improvements, fixtures and equipment and inventory (net of accounts payable). For these new stores, the net sales per store have averaged \$0.7 million per month.

Our new stores have typically been profitable on an operating basis within their first three to six months of operation and, on average have returned our net cash investment in 20 months or less. We consider a new store to be successful if it achieves \$8 million to \$9 million in sales volume and 2% to 5% in operating margins before other ancillary revenues and allocations of overhead and advertising in the first full year of operation. We expect successful stores that have matured, which generally occurs after two to three years of operations, to generate annual sales of approximately \$12 million to \$15 million and 5% to 9% in operating margins before other ancillary revenues and overhead and allocations. However, depending on the credit and insurance penetration of an individual store, we believe that a store that does not achieve these levels of sales can still contribute significantly to our pretax margin.

**Personnel and Compensation.** We staff a typical store with a store manager, an assistant manager, an average of 23 sales personnel and other support staff including cashiers and/or porters based on store size and location. Managers have an average tenure with us of approximately seven years and typically have prior sales floor experience. In addition to store managers, we have seven district managers that generally oversee from six to eight stores in each market. Our district managers generally have five to fifteen years of sales experience and report to our vice president of store operations, who has over twenty years of sales experience.

We compensate our sales associates on a straight commission arrangement, while we generally compensate store managers on a salary basis plus incentives and cashiers at an hourly rate. In some instances, store managers receive earned commissions plus base salary. Our clearance center is staffed with a manager and six to eight sales personnel who are paid on a straight commission arrangement. We believe that because our store compensation plans are tied to sales, they generally provide us an advantage in attracting and retaining highly motivated employees.

**Training.** New sales personnel must complete an intensive two week classroom training program conducted at our corporate office. We then require them to spend an additional week riding in a delivery and service truck to gain an understanding of how we serve our customers after the sale is made. Installation and delivery staff and service personnel receive training through an on-the-job program in which individuals are assigned to an experienced installation and delivery or service employee as helpers prior to working alone. In addition, our employees benefit from on-site training conducted by many of our vendors.

We attempt to identify store manager candidates early in their careers with us and place them in a defined program of training. They generally first attend our in-house training program, which provides guidance and direction for the development of managerial and supervisory skills. They then attend an external Dale Carnegie certified management course that helps solidify their management knowledge and builds upon their internal training. After completion of these training programs, manager candidates work as assistant managers for six to twelve months and are then allowed to manage one of our smaller stores, where they are supervised closely by the store's district manager. We give new managers an opportunity to operate larger stores as they become more proficient in their management skills. Each store manager attends mandatory training sessions on a monthly basis and also attends bi-weekly sales training meetings where participants receive and discuss new product information.

## **Marketing**

We design our marketing and advertising programs to increase our brand name recognition, educate consumers about our products and services and generate customer traffic in order to increase sales. Our programs include periodic promotions such as three, six, twelve, eighteen, twenty-four or thirty-six months of no interest financing. We conduct our advertising programs primarily through local newspapers, local radio and television stations and direct marketing through direct mail, telephone and our website.

Direct marketing has become an effective way for us to present our products and services to our existing customers and potential new customers. We use direct mail to target promotional mailings to credit worthy individuals, including new residents in our market areas from time to time. In addition, we use direct mail to market increased credit lines to existing customers, to encourage customers using third party credit to convert to our credit programs and for customer appreciation mailings. We also conduct a mail program to reestablish contact with customers who applied for credit recently at one of our stores but did not purchase a product. We also call customers who recently applied for credit at one of our retail locations but did not purchase a product; this often redirects potential purchasers back into the original store location.

Our website, [www.conns.com](http://www.conns.com), offers information about our selection of products and provides useful information to the consumer on pricing, features and benefits for each product and required corporate governance information. Our website also allows the customers residing in the markets in which we operate retail locations to apply and be considered for credit, to see our special on-line promotional items and to make purchases on-line through the use of approved credit cards. The website currently averages approximately 5,040 visits per day from potential and existing customers and during fiscal 2006, was the source of approximately 80,400 credit applications. The website is linked to a call center, allowing us to better assist customers with their credit and product needs.

### **Distribution and Inventory Management**

We typically locate our stores in close proximity of our five regional distribution centers located in Houston, San Antonio, Dallas and Beaumont, Texas and Lafayette, Louisiana and smaller cross-dock facilities in Austin and Harlingen, Texas. This enables us to deliver products to our customers quickly, reduces inventory requirements at the individual stores and facilitates regionalized inventory and accounting controls.

In our retail stores, we maintain an inventory of fast-moving items and products that the customer is likely to carry out of the store. Our sophisticated Distribution Inventory Sales computer system and the recent introduction of scanning technology in our distribution centers allow us to determine on a real-time basis the exact location of any product we sell. If we do not have a product at the desired retail store at the time of sale, we can provide it through our distribution system on a next day basis.

We maintain a fleet of tractors and trailers that allow us to move products from market to market and from distribution centers to stores. Our fleet of home delivery vehicles enables our highly-trained delivery and installation specialists to quickly complete the sales process, enhancing customer service. We receive a delivery fee based on their choice of same day or next day delivery. Additionally, we are able to complete deliveries to our customers on the same day as, or the day after the sale for approximately 95% of our customers who have requested delivery.

## Finance Operations

**General.** We sell our products for cash or for payment through major credit cards, which we treat as cash sales. We also offer our customers several financing alternatives through our proprietary credit programs. In the last three fiscal years, we financed, on average, approximately 57% of our retail sales through one of our two credit programs. We offer our customers a choice of installment payment plans and revolving credit plans through our primary credit portfolio. We also offer an installment program through our secondary credit portfolio to a limited number of customers who do not qualify for credit under our primary credit portfolio. The following table shows our product sales and gross service maintenance agreements sales, excluding returns and allowances and service revenues, by method of payment for the periods indicated.

	Years Ended January 31,					
	2004		2005		2006	
	Amount	%	Amount	%	Amount	%
	(dollars in thousands)					
Cash and other credit cards.....	\$ 198,765	47.0%	\$ 193,753	40.8%	\$ 254,047	42.3%
Primary credit portfolio:						
Installment .....	182,802	43.3	225,369	47.4	263,667	43.9
Revolving .....	16,627	3.9	20,663	4.3	30,697	5.1
Secondary credit portfolio .....	24,459	5.8	35,725	7.5	52,049	8.7
Total .....	<u>\$ 422,653</u>	<u>100.0%</u>	<u>\$ 475,510</u>	<u>100.0%</u>	<u>\$ 600,460</u>	<u>100.0%</u>

**Credit Approval.** Our credit programs are operated by our centralized credit department staff, completely independent of sales personnel. As part of our centralized credit approval process, we have developed a proprietary standardized scoring model that provides preliminary credit decisions, including down payment amounts and credit terms, based on both customer and product risk. We developed this model with data analysis by Equifax® to correlate the product category of a customer purchase with the default probability. Although we rely on this program to approve automatically some credit applications from customers for whom we have previous credit experience, over 92.8% of our credit decisions are based on evaluation of the customer's creditworthiness by a qualified credit grader. As of January 31, 2006, we employed approximately 400 full-time and part-time employees who focus on credit approval and collections. These employees are highly trained to follow our strict methodology in approving credit, collecting our accounts, and charging off any uncollectible accounts based on pre-determined aging criteria.

A significant part of our ability to control delinquency and charge-off rates is tied to the relatively high level of down payments that we require and the purchase money security interest that we obtain in the product financed, which reduce our credit risk and increase our customers' willingness to meet their future obligations. We require the customer to provide proof of credit property insurance coverage to offset potential losses relating to theft or damage of the product financed.

Installment accounts are paid over a specified period of time with set monthly payments. Revolving accounts provide customers with a specified amount which the customer may borrow, repay and re-borrow so long as the credit limit is not exceeded. Most of our installment accounts provide for payment over 12 to 36 months, and for those accounts paid in full during fiscal 2006, the average account was outstanding for approximately 13 to 15 months. Our revolving accounts were outstanding approximately 12 to 17 months for those accounts paid in full during fiscal 2006. During fiscal 2006, approximately 7.2% of the applications approved under the primary program were handled automatically through our computer system based on previous credit history with us. We automatically send the application of any new credit customer or any customer seeking additional credit where there has been a past delinquency or performance problem to an experienced, in-house credit grader.

We created our secondary credit portfolio program to meet the needs of those customers who do not qualify for credit under our primary program. If we cannot approve a customer's application for credit under our primary portfolio, we automatically send the application to the credit staff of our secondary portfolio for further consideration. We offer only the installment program to these customers, and we grant credit to these consumers under stricter underwriting criteria, including higher down payments. An experienced, in-house credit grader administers the credit approval process. Most of the installment accounts approved under this program

provide for repayment over 12 to 36 months, and for those accounts paid in full during fiscal 2006, the average account was outstanding for approximately 13 to 15 months.

The following two tables present, for comparison purposes, information regarding our two credit portfolios.

<b>Primary Portfolio (1)</b>			
<b>Years Ended January 31,</b>			
	<b>2004</b>	<b>2005</b>	<b>2006</b>
(total outstanding balance in thousands)			
Total outstanding balance (period end).....	\$ 293,909	\$ 358,252	\$ 421,649
Average outstanding customer balance.....	\$ 1,189	\$ 1,268	\$ 1,284
Number of active accounts (period end).....	247,151	282,533	328,402
Total applications processed (2).....	499,755	567,352	684,674
Percent of retail sales financed.....	47.2%	51.7%	49.0%
Total applications approved.....	59.3%	56.4%	52.8%
Average down payment.....	8.6%	7.4%	7.6%
Average interest spread (3).....	12.2%	12.7%	12.0%

<b>Secondary Portfolio</b>			
<b>Years Ended January 31,</b>			
	<b>2004</b>	<b>2005</b>	<b>2006</b>
(total outstanding balance in thousands)			
Total outstanding balance (period end).....	\$ 55,561	\$ 70,448	\$ 98,072
Average outstanding customer balance.....	\$ 1,057	\$ 1,040	\$ 1,128
Number of active accounts (period end).....	52,566	67,718	86,936
Total applications processed (2).....	192,228	238,605	314,698
Percent of retail sales financed.....	5.8%	7.5%	8.7%
Total applications approved.....	26.9%	33.3%	34.1%
Average down payment.....	27.7%	27.2%	26.4%
Average interest spread (3).....	13.0%	14.0%	14.1%

(1) The Primary Portfolio consists of owned and sold receivables.

(2) Unapproved credit applications in the primary portfolio are automatically referred to the secondary portfolio.

(3) Difference between the average interest rate yield on the portfolio and the average cost of funds under the program plus the allocated interest related to funds required to finance the credit enhancement portion of the portfolio. Also reflects the loss of interest income resulting from interest free promotional programs.

**Credit Quality.** We enter into securitization transactions to sell our retail receivables to a qualifying special purpose entity or QSPE, which we formed for this purpose. After the sale, we continue to service these receivables under a contract with the QSPE. We closely monitor these credit portfolios to identify delinquent accounts early and dedicate resources to contacting customers concerning past due accounts. We believe that our local presence, ability to work with customers and flexible financing alternatives contribute to the historically low charge-off rates on these portfolios. In addition, our customers have the opportunity to make their monthly payments in our stores, and approximately 58% of our active credit accounts did so at some time during the last 12 months. We believe that these factors help us maintain a relationship with the customer that keeps losses low while encouraging repeat purchases.

Our follow-up collection activities involve a combination of centralized efforts that take place in our corporate office and outside collection efforts that involve a visit by one of our credit counselors to the customer's home. We maintain a sophisticated predictive dialer system and letter campaign that helps us contact between 20,000 and 25,000 delinquent customers daily. We also maintain a very experienced skip-trace department that utilizes current technology to locate customers who have moved and left no forwarding address. Our outside collectors provide an on-site contact with the customer to assist in the collection process or, if needed, to actually repossess the product in the event of non-payment. Repossessions are made when it is clear that the customer is unwilling to establish a reasonable payment process. Our legal department represents us in bankruptcy proceedings and filing of delinquency judgment claims and helps handle any legal issues associated with the collection process.

Generally, we deem an account to be uncollectible and charge it off if the account is 120 days or more past due and has not had a payment in the last seven months. Over the last 36 months, we have recovered approximately 19% of charged-off amounts through our collection activities. The income that we realize from our interest in securitized receivables depends on a number of factors, including expected credit losses. Therefore, it is to our advantage to maintain a low delinquency rate and loss ratio on these credit portfolios.

Our accounting and credit staff consistently monitors trends in charge-offs by examining the various characteristics of the charge-offs, including store of origination, product type, customer credit information, down payment amounts and other identifying information. We track our charge-offs both gross, or before recoveries, and net, or after recoveries. We periodically adjust our credit granting, collection and charge-off policies based on this information.

The following table reflects the performance of our two credit portfolios, net of unearned interest.

	Primary Portfolio (1)			Secondary Portfolio		
	Years Ended January 31,			Years Ended January 31,		
	2004	2005	2006	2004	2005	2006
	(dollars in thousands)			(dollars in thousands)		
Average total outstanding balance.....	\$ 293,909	\$ 358,252	\$ 421,649	\$ 55,561	\$ 70,448	\$ 98,072
Account balances over 60 days old (period end).....	\$ 13,484	\$ 17,503	\$ 26,029	\$ 4,783	\$ 5,640	\$ 9,508
Percent of balances over 60 days old to total outstanding (period end) (2).....	4.6%	4.9%	6.2%	8.6%	8.0%	9.7%
Allowance for doubtful accounts (period end).....	\$ 9,534	\$ 10,168	\$ 11,464	\$ 2,224	\$ 2,089	\$ 2,348
Percent allowance for doubtful accounts to total outstanding (period end).....	3.2%	2.8%	2.7%	4.0%	3.0%	2.4%
Bad debt write-offs (net of recoveries).....	\$ 7,905	\$ 7,601	\$ 10,225	\$ 1,499	\$ 1,604	\$ 1,915
Percent of write-offs (net) to average outstanding (3)....	2.9%	2.4%	2.6%	2.7%	2.5%	2.2%

(1) The Primary Portfolio consists of owned and sold receivables.

(2) At January 31, 2006, the percent of balances over 60 days old was elevated due to the impact of Hurricanes Katrina and Rita. See additional discussion in Management's Discussion and Analysis of Financial Condition and Results of Operations.

(3) The fiscal year ended January 31, 2005, includes the benefit of new information received during the year, which impacted the realization of sales tax credits on prior year write-offs.

The following table presents information regarding the growth of our combined credit portfolios, including unearned interest.

	Years Ended January 31,		
	2004	2005	2006
	(dollars in thousands)		
Beginning balance.....	\$ 362,076	\$ 418,702	\$ 514,204
New receivables financed.....	331,849	423,935	495,553
Revolving finance charges.....	4,354	3,926	3,858
Returns on account.....	(6,860)	(10,670)	(5,397)
Collections on account.....	(263,313)	(312,484)	(375,342)
Accounts charged off.....	(11,934)	(11,825)	(14,392)
Recoveries of charge-offs.....	2,530	2,620	2,252
Ending balance.....	418,702	514,204	620,736
Less unearned interest at end of period.....	(69,232)	(85,504)	(101,015)
Total portfolio, net.....	\$ 349,470	\$ 428,700	\$ 519,721

## Product Support Services

**Credit Insurance.** Acting as agents for unaffiliated insurance companies, we sell credit life, credit disability, credit involuntary unemployment and credit property insurance at all of our stores. These products cover payment of the customer's credit account in the event of the customer's death, disability or involuntary unemployment or if the financed property is lost or damaged. We receive sales commissions from the unaffiliated insurance company at the time we sell the coverage, and we recognize retrospective commissions,

which are additional commissions paid by the insurance carrier if insurance claims are lower than projected, as such commissions are actually earned.

We require proof of property insurance on all installment credit purchases, although we do not require that customers purchase this insurance from us. During fiscal 2006, approximately 75.2% of our credit customers purchased one or more of the credit insurance products we offer, and approximately 29.1% purchased all of the insurance products we offer. Commission revenues from the sale of credit insurance contracts represented approximately 3.3%, 3.2% and 2.6% of total revenues for fiscal years 2004, 2005 and 2006, respectively.

**Warranty Service.** We provide warranty service for all of the products we sell and only for the products we sell. Customers purchased service maintenance agreements on products representing approximately 48.8% of our total retail sales for fiscal 2006. These agreements broaden and extend the period of covered manufacturer warranty service for up to five years from the date of purchase, depending on the product, and cover certain items during the manufacturer's warranty period. These agreements are sold at the time the product is purchased. Customers may finance the cost of the agreements along with the purchase price of the associated product. We contact the customer prior to the expiration of the service maintenance period to provide them the opportunity to renew the period of warranty coverage.

We have contracts with unaffiliated third party insurers that issue the service maintenance agreements to cover the costs of repairs performed by our service department under these agreements. The initial service contract is between the customer and the independent insurance company, but we are the insurance company's first choice to provide service when it is needed. We receive a commission on the sale of the contract, and we bill the insurance company for the cost of the service work that we perform. Commissions on these third party contracts are recognized in revenues, net of the payment to the third party obligor. Renewal contracts are between the customer and our in-house service department. Under renewal contracts we recognize revenues received, and direct selling expenses incurred, over the life of the contracts, and expense the cost of the service work performed as products are repaired.

Of the 15,000 to 20,000 repairs that we perform each month, approximately 35.4% are covered under these service maintenance agreements, approximately 50.5% are covered by manufacturer warranties and the remainder are "walk-in" repairs from our customers. Revenues from the sale of service contracts represented approximately 4.6%, 4.8%, and 4.9% of net sales during fiscal years 2004, 2005 and 2006, respectively.

### **Management Information Systems**

We have a fully integrated management information system that tracks on a real-time basis point-of-sale information, inventory receipt and distribution, merchandise movement and financial information. The management information system also includes a local area network that connects all corporate users to e-mail, scheduling and various servers. All of our facilities are linked by a wide-area network that provides communication for in-house credit authorization and real time polling of sales and merchandise movement at the store level. In our distribution centers, we use radio frequency terminals to assist in receiving, stock put-away, stock movement, order filling, cycle counting and inventory management. At our stores, we currently use desktop terminals to assist in receiving, transferring and maintaining perpetual inventories.

Our integrated management information system also includes extensive functionality for management of the complete credit portfolio life cycle as well as functionality for the management of product service. The credit system continues from our in-house credit authorization through account set up and tracking, credit portfolio condition, collections, credit employee productivity metrics, skip-tracing, bankruptcy and fraud and legal account management. The service system provides for service order processing, warranty claims processing, parts inventory management, technician scheduling and dispatch, technician performance metrics and customer satisfaction measurement. All of these systems share a common customer and product sold database.

Our point of sale system uses an IBM Series i5 hardware system that runs on the i5OS operating system. This system enables us to use a variety of readily available applications in conjunction with software that supports the system. All of our current business application software, except our accounting and human resources systems, has been developed in-house by our management information system employees. We believe our management information systems efficiently support our current operations and provide a foundation for future growth.

We employ a Nortel telephone switch and state of the art Avaya (formerly Mosaix) predictive dialer, as well as a redundant data network and cable plant, to improve the efficiency of our collection and overall corporate communication efforts.

As part of our ongoing system availability protection and disaster recovery planning, we have implemented a secondary IBM Series i5 system. We installed and implemented a back-up IBM Series i5 system in our corporate offices to provide the ability to switch production processing from the primary system to the secondary system within fifteen to thirty minutes should the primary system become disabled or unreachable. The two machines are kept synchronized utilizing third party software. This backup system provides "high availability" of the production processing environment. The primary IBM Series i5 system is geographically removed from our corporate office for purposes of disaster recovery and security. These systems worked as designed during our recent evacuation from our corporate headquarters in Beaumont, Texas, due to Hurricane Rita. While we were displaced, our store, distribution and service operations that were not impacted by the hurricane continued to have normal system availability and functionality.

## **Competition**

According to *Twice*, total industry manufacturer sales of home appliances and consumer electronics products in the United States, including imports, to the top 100 dealers were estimated to be \$21.3 billion and \$96.4 billion, respectively, in 2004. The retail home appliance market is large and concentrated among a few major suppliers. Sears has historically been the leader in the retail home appliance market, with a market share among the top 100 retailers of approximately 39% in 2004, down from 42% in 2003. The consumer electronics market is highly fragmented. We estimate that the two largest consumer electronics superstore chains accounted for less than 35% of the total electronics sales attributable to the 100 largest retailers in 2003. However, new entrants in both industries have been successful in gaining market share by offering similar product selections at lower prices.

As reported by *Twice*, based upon revenue in 2004, we were the 12th largest retailer of home appliances. Our competitors include national mass merchants such as Sears and Wal-Mart, specialized national retailers such as Circuit City and Best Buy, home improvement stores such as Lowe's and Home Depot, and locally-owned regional or independent retail specialty stores. The availability and convenience of the Internet and other direct-to-consumer alternatives are increasing as a competitive factor in our industry, especially for distribution of computer and entertainment software.

We compete primarily based on enhanced customer service through our unique sales force training and product knowledge, same day or next day delivery capabilities, proprietary in-house credit program, guaranteed low prices and product repair service.

## **Regulation**

The extension of credit to consumers is a highly regulated area of our business. Numerous federal and state laws impose disclosure and other requirements on the origination, servicing and enforcement of credit accounts. These laws include, but are not limited to, the Federal Truth in Lending Act, Equal Credit Opportunity Act and Federal Trade Commission Act. State laws impose limitations on the maximum amount of finance charges that we can charge and also impose other restrictions on consumer creditors, such as us, including restrictions on collection and enforcement. We routinely review our contracts and procedures to ensure compliance with applicable consumer credit laws. Failure on our part to comply with applicable laws could expose us to substantial penalties and claims for damages and, in certain circumstances, may require us to refund finance charges already paid and to forego finance charges not yet paid under non-complying contracts. We believe that we are in substantial compliance with all applicable federal and state consumer credit and collection laws.

Our sale of credit life, credit disability, credit involuntary unemployment and credit property insurance products is also highly regulated. State laws currently impose disclosure obligations with respect to our sales of credit and other insurance products similar to those required by the Federal Truth in Lending Act, impose restrictions on the amount of premiums that we may charge and require licensing of certain of our employees and operating entities. We believe we are in substantial compliance with all applicable laws and regulations relating to our credit insurance business.

## **Employees**

As of January 31, 2006, we had approximately 2,600 full-time employees and 200 part-time employees, of which approximately 1,200 were sales personnel. We provide a comprehensive benefits package including health, life, long term disability, and dental insurance coverage as well as a 401(k) plan, employee stock purchase plan, paid vacation, sick pay and holiday pay. None of our employees are covered by collective bargaining agreements and we believe our employee relations are good.

## **Tradenames and Trademarks**

We have registered the trademarks "Conn's" and our logos.

## **Available Information**

We are subject to reporting requirements of the Securities Exchange Act of 1934, or the Exchange Act, and its rules and regulations. The Exchange Act requires us to file reports, proxy and other information statements and other information with the Securities and Exchange Commission ("SEC"). Copies of these reports, proxy statements and other information can be inspected and copied at the SEC Public Reference Room, 450 Fifth Street, N.W., Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. You may also obtain these materials electronically by accessing the SEC's home page on the internet at [www.sec.gov](http://www.sec.gov).

In addition, we make available, free of charge on our internet website, our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to these reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after we electronically file this material with, or furnish it to, the SEC. You may review these documents, under the heading "Conn's Investor Relations," by accessing our website at [www.conns.com](http://www.conns.com). Also, reports and other information concerning us are available for inspection and copying at NASDAQ Capital Markets.

## ITEM 1A. RISK FACTORS.

*An investment in our common stock involves risks and uncertainties. You should consider carefully the following information about these risks and uncertainties before buying shares of our common stock. The occurrence of any of the risks described below could adversely affect our business, financial condition or results of operations. In that case, the trading price of our stock could decline, and you could lose all or part of the value of your investment.*

**Our success depends substantially on our ability to open and operate profitably new stores in existing, adjacent and new geographic markets.**

We plan to continue our expansion by opening an additional six to eight new stores in fiscal 2007. We anticipate these new stores to include additional stores in the Dallas/Fort Worth Metroplex, South Texas, where we currently have two stores, and possibly others in areas where we have not operated previously. We have not yet selected sites for all of the stores that we plan to open within the next fiscal year. We may not be able to open all of these stores, and any new stores that we open may not be profitable or meet our goals. Any of these circumstances could have a material adverse effect on our financial results.

There are a number of factors that could affect our ability to open and operate new stores consistent with our business plan, including:

- competition in existing, adjacent and new markets;
- competitive conditions, consumer tastes and discretionary spending patterns in adjacent and new markets that are different from those in our existing markets;
- a lack of consumer demand for our products at levels that can support new store growth;
- limitations created by covenants and conditions under our credit facilities and our asset-backed securitization program;
- the availability of additional financial resources;
- the substantial outlay of financial resources required to open new stores and the possibility that we may recognize little or no related benefit;
- an inability or unwillingness of vendors to supply product on a timely basis at competitive prices;
- the failure to open enough stores in new markets to achieve a sufficient market presence;
- the inability to identify suitable sites and to negotiate acceptable leases for these sites;
- unfamiliarity with local real estate markets and demographics in adjacent and new markets;
- problems in adapting our distribution and other operational and management systems to an expanded network of stores;
- difficulties associated with the hiring, training and retention of additional skilled personnel, including store managers; and
- higher costs for print, radio and television advertising.

These factors may also affect the ability of any newly opened stores to achieve sales and profitability levels comparable with our existing stores or to become profitable at all.

**If we are unable to manage our growing business, our revenues may not increase as anticipated, our cost of operations may rise and our profitability may decline.**

We face many business risks associated with growing companies, including the risk that our management, financial controls and information systems will be inadequate to support our planned expansion. Our growth plans will require management to expend significant time and effort and additional resources to ensure the continuing adequacy of our financial controls, operating procedures, information systems, product purchasing, warehousing and distribution systems and employee training programs. We cannot predict whether we will be able to manage effectively these increased demands or respond on a timely basis to the changing demands that our planned expansion will impose on our management, financial controls and information systems. If we fail to manage successfully the challenges our growth poses, do not continue to improve these systems and controls or encounter unexpected difficulties during our expansion, our business, financial condition, operating results or cash flows could be materially adversely affected.

**The inability to obtain funding for our credit operations through securitization facilities or other sources may adversely affect our business and expansion plans.**

We finance most of our customer receivables through asset-backed securitization facilities. The trust arrangement governing these facilities currently provides for two separate series of asset-backed notes that allow us to finance up to \$450 million in customer receivables. Under each note series, we transfer customer receivables to a qualifying special purpose entity we formed for this purpose in exchange for cash, subordinated securities and the right to receive cash flows equal to the interest rate spread between the transferred receivables and the notes issued to third parties ("interest only strip"). This qualifying special purpose entity, in turn, issues notes that are collateralized by these receivables and entitle the holders of the notes to participate in certain cash flows from these receivables. The Series A program is a \$250 million variable funding note held by Three Pillars Funding Corporation, of which \$185.0 million was drawn as of January 31, 2006. The Series B program consists of \$200 million in private bond placements that will require scheduled principal payments beginning in October 2006.

Our ability to raise additional capital through further securitization transactions, and to do so on economically favorable terms, depends in large part on factors that are beyond our control.

These factors include:

- conditions in the securities and finance markets generally;
- conditions in the markets for securitized instruments;
- the credit quality and performance of our customer receivables;
- our ability to obtain financial support for required credit enhancement;
- our ability to service adequately our financial instruments;
- the absence of any material downgrading or withdrawal of ratings given to our securities previously issued in securitizations; and
- prevailing interest rates.

Our ability to finance customer receivables under our current asset-backed securitization facilities depends on our compliance with covenants relating to our business and our customer receivables. If these programs reach their capacity or otherwise become unavailable, and we are unable to arrange substitute securitization facilities or other sources of financing, we may have to limit the amount of credit that we make available through our customer finance programs. This may adversely affect revenues and results of operations. Further, our inability to obtain funding through securitization facilities or other sources may adversely affect the profitability of outstanding accounts under our credit programs if existing customers fail to repay outstanding credit due to our refusal to grant additional credit. Since our cost of funds under our bank

credit facility is expected to be greater in future years than our cost of funds under our current securitization facility, increased reliance on our bank credit facility may adversely affect our net income.

**An increase in interest rates may adversely affect our profitability.**

The interest rates on our bank credit facility and the Series A program under our asset-backed securitization facility fluctuate up or down based upon the LIBO/LIBOR rate, the prime rate of our administrative agent or the federal funds rate in the case of the bank credit facility and the commercial paper rate in the case of the Series A program. To the extent that such rates increase, the fair value of the interest only strip will decline and our interest expense could increase which may result in a decrease in our profitability.

**We have significant future capital needs which we may be unable to fund, and we may need additional funding sooner than currently anticipated.**

We will need substantial capital to finance our expansion plans, including funds for capital expenditures, pre-opening costs and initial operating losses related to new store openings. We may not be able to obtain additional financing on acceptable terms. If adequate funds are not available, we will have to curtail projected growth, which could materially adversely affect our business, financial condition, operating results or cash flows.

We estimate that capital expenditures during fiscal 2007 will be approximately \$25 million to \$30 million and that capital expenditures during future years may exceed this amount. We expect that cash provided by operating activities, available borrowings under our credit facility, and access to the unfunded portion of our asset-backed securitization program will be sufficient to fund our operations, store expansion and updating activities and capital expenditure programs through at least January 31, 2007. However, this may not be the case. We may be required to seek additional capital earlier than anticipated if future cash flows from operations fail to meet our expectations and costs or capital expenditures related to new store openings exceed anticipated amounts.

**A decrease in our credit sales could lead to a decrease in our product sales and profitability.**

In the last three years, we financed, on average, approximately 57% of our retail sales through our internal credit programs. Our ability to provide credit as a financing alternative for our customers depends on many factors, including the quality of our accounts receivable portfolio. Payments on some of our credit accounts become delinquent from time to time, and some accounts end up in default, due to several factors, including general and local economic conditions. As we expand into new markets, we will obtain new credit accounts that may present a higher risk than our existing credit accounts since new credit customers do not have an established credit history with us. A general decline in the quality of our accounts receivable portfolio could lead to a reduction of available credit provided through our finance operations. As a result, we might sell fewer products, which could adversely affect our earnings. Further, because approximately 58% of our credit customers make their credit account payments in our stores, any decrease in credit sales could reduce traffic in our stores and lower our revenues. A decline in the credit quality of our credit accounts could also cause an increase in our credit losses, which could result in a decrease in our securitization income or increase the provision for bad debts on our statement of operations and result in an adverse effect on our earnings. A decline in credit quality could also lead to stricter underwriting criteria which might have a negative impact on sales.

**A downturn in the economy may affect consumer purchases of discretionary items, which could reduce our net sales.**

A large portion of our sales represent discretionary spending by our customers. Many factors affect discretionary spending, including world events, war, conditions in financial markets, general business conditions, interest rates, inflation, energy and gasoline prices, consumer debt levels, the availability of consumer credit, taxation, unemployment trends and other matters that influence consumer confidence and spending. Our customers' purchases of discretionary items, including our products, could decline during periods when disposable income is lower or periods of actual or perceived unfavorable economic conditions. If this occurs, our net sales and profitability could decline.

**We face significant competition from national, regional and local retailers of major home appliances and consumer electronics.**

The retail market for major home appliances and consumer electronics is highly fragmented and intensely competitive. We currently compete against a diverse group of retailers, including national mass merchants such as Sears, Wal-Mart, Target, Sam's Club and Costco, specialized national retailers such as Circuit City and Best Buy, home improvement stores such as Lowe's and Home Depot, and locally-owned regional or independent retail specialty stores that sell major home appliances and consumer electronics similar, and often identical, to those we sell. We also compete with retailers that market products through store catalogs and the Internet. In addition, there are few barriers to entry into our current and contemplated markets, and new competitors may enter our current or future markets at any time.

We may not be able to compete successfully against existing and future competitors. Some of our competitors have financial resources that are substantially greater than ours and may be able to purchase inventory at lower costs and better sustain economic downturns. Our competitors may respond more quickly to new or emerging technologies and may have greater resources to devote to promotion and sale of products and services. If two or more competitors consolidate their businesses or enter into strategic partnerships, they may be able to compete more effectively against us.

Our existing competitors or new entrants into our industry may use a number of different strategies to compete against us, including:

- expansion by our existing competitors or entry by new competitors into markets where we currently operate;
- lower pricing;
- aggressive advertising and marketing;
- extension of credit to customers on terms more favorable than we offer;
- larger store size, which may result in greater operational efficiencies, or innovative store formats; and
- adoption of improved retail sales methods.

Competition from any of these sources could cause us to lose market share, revenues and customers, increase expenditures or reduce prices, any of which could have a material adverse effect on our results of operations.

**If new products are not introduced or consumers do not accept new products, our sales may decline.**

Our ability to maintain and increase revenues depends to a large extent on the periodic introduction and availability of new products and technologies. We believe that the introduction and continued growth in consumer acceptance of new products, such as digital video recorders and digital, high-definition televisions, will have a significant impact on our ability to increase revenues. These products are subject to significant technological changes and pricing limitations and are subject to the actions and cooperation of third parties, such as movie distributors and television and radio broadcasters, all of which could affect the success of these and other new consumer electronics technologies. It is possible that new products will never achieve widespread consumer acceptance.

**If we fail to anticipate changes in consumer preferences, our sales may decline.**

Our products must appeal to a broad range of consumers whose preferences cannot be predicted with certainty and are subject to change. Our success depends upon our ability to anticipate and respond in a timely manner to trends in consumer preferences relating to major household appliances and consumer electronics. If we fail to identify and respond to these changes, our sales of these products may decline. In addition, we often make commitments to purchase products from our vendors up to six months in advance of proposed delivery dates. Significant deviation from the projected demand for products that we sell may have a material adverse

effect on our results of operations and financial condition, either from lost sales or lower margins due to the need to reduce prices to dispose of excess inventory.

**A disruption in our relationships with, or in the operations of, any of our key suppliers could cause our sales to decline.**

The success of our business and growth strategies depends to a significant degree on our relationships with our suppliers, particularly our brand name suppliers such as General Electric, Whirlpool, Frigidaire, Maytag, LG, Mitsubishi, Sony, Hitachi, Samsung, Toshiba, Serta, Hewlett Packard and Compaq. We do not have long term supply agreements or exclusive arrangements with the majority of our vendors. We typically order our inventory through the issuance of individual purchase orders to vendors. We also rely on our suppliers for cooperative advertising support. We may be subject to rationing by suppliers with respect to a number of limited distribution items. In addition, we rely heavily on a relatively small number of suppliers. Our top six suppliers represented 60.6% of our purchases for fiscal 2006, and the top two suppliers represented approximately 29.2% of our total purchases. The loss of any one or more of these key vendors or our failure to establish and maintain relationships with these and other vendors could have a material adverse effect on our results of operations and financial condition.

Our ability to enter new markets successfully depends, to a significant extent, on the willingness and ability of our vendors to supply merchandise to additional warehouses or stores. If vendors are unwilling or unable to supply some or all of their products to us at acceptable prices in one or more markets, our results of operations and financial condition could be materially adversely affected.

Furthermore, we rely on credit from vendors to purchase our products. As of January 31, 2006, we had \$40.9 million in accounts payable and \$74.0 million in merchandise inventories. A substantial change in credit terms from vendors or vendors' willingness to extend credit to us would reduce our ability to obtain the merchandise that we sell, which could have a material adverse effect on our sales and results of operations.

**You should not rely on our comparable store sales as an indication of our future results of operations because they fluctuate significantly.**

Our historical same store sales growth figures have fluctuated significantly from quarter to quarter. For example, same store sales growth for each of the quarters of fiscal 2006 were 7.3%, 12.1%, 23.3%, and 22.6%, respectively. Even though we achieved double-digit same store sales growth during fiscal 2006, we may not be able to increase same store sales at this pace in the future. A number of factors have historically affected, and will continue to affect, our comparable store sales results, including:

- changes in competition;
- general economic conditions;
- new product introductions;
- consumer trends;
- changes in our merchandise mix;
- changes in the relative sales price points of our major product categories;
- the impact of our new stores on our existing stores, including potential decreases in existing stores' sales as a result of opening new stores;
- weather conditions in our markets;
- timing of promotional events;
- timing and location of major sporting events; and

- our ability to execute our business strategy effectively.

Changes in our quarterly and annual comparable store sales results could cause the price of our common stock to fluctuate significantly.

**Because we experience seasonal fluctuations in our sales, our quarterly results will fluctuate, which could adversely affect our common stock price.**

We experience seasonal fluctuations in our net sales and operating results. In fiscal 2006, we generated 29.4% of our net sales and 31.4% of our net income in the fiscal quarter ended January 31 (which included the holiday selling season). We also incur significant additional expenses during this fiscal quarter due to higher purchase volumes and increased staffing. If we miscalculate the demand for our products generally or for our product mix during the fiscal quarter ending January 31, our net sales could decline, resulting in excess inventory, which could harm our financial performance. A shortfall in expected net sales, combined with our significant additional expenses during this fiscal quarter, could cause a significant decline in our operating results. This could adversely affect our common stock price.

**Our business could be adversely affected by changes in consumer protection laws and regulations.**

Federal and state consumer protection laws and regulations, such as the Fair Credit Reporting Act, limit the manner in which we may offer and extend credit. Since we finance a substantial portion of our sales, any adverse change in the regulation of consumer credit could adversely affect our total revenues and gross margins. For example, new laws or regulations could limit the amount of interest or fees that may be charged on consumer loan accounts or restrict our ability to collect on account balances, which would have a material adverse effect on our earnings. Compliance with existing and future laws or regulations could require us to make material expenditures, in particular personnel training costs, or otherwise adversely affect our business or financial results. Failure to comply with these laws or regulations, even if inadvertent, could result in negative publicity, fines or additional licensing expenses, any of which could have an adverse effect on our results of operations and stock price.

**Pending litigation relating to the sale of credit insurance and the sale of service maintenance agreements in the retail industry, including one lawsuit in which we were the defendant, could adversely affect our business.**

We understand that states' attorneys general and private plaintiffs have filed lawsuits against other retailers relating to improper practices conducted in connection with the sale of credit insurance in several jurisdictions around the country. We offer credit insurance in all of our stores and require the purchase of property credit insurance products from us or from third party providers in connection with sales of merchandise on installment credit; therefore, similar litigation could be brought against us. We were previously named as a defendant in a purported class action lawsuit alleging breach of contract and violations of state and federal consumer protection laws arising from the terms of our service maintenance agreements. A final judgment was entered dismissing that lawsuit. While we believe we are in full compliance with applicable laws and regulations, if we are found liable in any future lawsuit regarding credit insurance or service maintenance agreements, we could be required to pay substantial damages or incur substantial costs as part of an out-of-court settlement, either of which could have a material adverse effect on our results of operations and stock price. An adverse judgment or any negative publicity associated with our service maintenance agreements or any potential credit insurance litigation could also affect our reputation, which could have a negative impact on sales.

**If we lose key management or are unable to attract and retain the highly qualified sales personnel required for our business, our operating results could suffer.**

Our future success depends to a significant degree on the skills, experience and continued service of Thomas J. Frank, Sr., our Chairman of the Board and Chief Executive Officer, William C. Nylin, Jr., our President and Chief Operating Officer, David L. Rogers, our Chief Financial Officer, David R. Atnip, our Senior Vice President and Treasurer, Sydney K. Boone, our Secretary and General Counsel, and other key personnel. If we lose the services of any of these individuals, or if one or more of them or other key personnel decide to join a competitor or otherwise compete directly or indirectly with us, our business and operations could be harmed,

and we could have difficulty in implementing our strategy. In addition, as our business grows, we will need to locate, hire and retain additional qualified sales personnel in a timely manner and develop, train and manage an increasing number of management level sales associates and other employees. Competition for qualified employees could require us to pay higher wages to attract a sufficient number of employees, and increases in the federal minimum wage or other employee benefits costs could increase our operating expenses. If we are unable to attract and retain personnel as needed in the future, our net sales growth and operating results could suffer.

**Because our stores are located in Texas and Louisiana, we are subject to regional risks.**

Our 56 stores are located exclusively in Texas and Louisiana. This subjects us to regional risks, such as the economy, weather conditions, hurricanes and other natural disasters. If the region suffered an economic downturn or other adverse regional event, there could be an adverse impact on our net sales and profitability and our ability to implement our planned expansion program. Several of our competitors operate stores across the United States and thus are not as vulnerable to the risks of operating in one region.

**Our information technology infrastructure is vulnerable to damage that could harm our business.**

Our ability to operate our business from day to day, in particular our ability to manage our credit operations and inventory levels, largely depends on the efficient operation of our computer hardware and software systems. We use management information systems to track inventory information at the store level, communicate customer information, aggregate daily sales information and manage our credit portfolio. These systems and our operations are vulnerable to damage or interruption from:

- power loss, computer systems failures and Internet, telecommunications or data network failures;
- operator negligence or improper operation by, or supervision of, employees;
- physical and electronic loss of data or security breaches, misappropriation and similar events;
- computer viruses;
- intentional acts of vandalism and similar events; and
- hurricanes, fires, floods and other natural disasters.

The software that we have developed to use in granting credit may contain undetected errors that could cause our network to fail or our expenses to increase. Any failure due to any of these causes, if it is not supported by our disaster recovery plan, could cause an interruption in our operations and result in reduced net sales and profitability.

**If we are unable to maintain our current insurance coverage for our service maintenance agreements, our customers could incur additional costs and our repair expenses could increase, which could adversely affect our financial condition and results of operations.**

There are a limited number of insurance carriers that provide coverage for our service maintenance agreements. If insurance becomes unavailable from our current carriers for any reason, we may be unable to provide replacement coverage on the same terms, if at all. Even if we are able to obtain replacement coverage, higher premiums could have an adverse impact on our profitability if we are unable to pass along the increased cost of such coverage to our customers. Inability to obtain insurance coverage for our service maintenance agreements could cause fluctuations in our repair expenses and greater volatility of earnings.

**If we are unable to maintain group credit insurance policies from insurance carriers, which allow us to offer their credit insurance products to our customers purchasing on credit, our revenues could be reduced and bad debts might increase.**

There are a limited number of insurance carriers that provide credit insurance coverage for sale to our customers. If credit insurance becomes unavailable for any reason we may be unable to offer replacement coverage on the same terms, if at all. Even if we are able to obtain replacement coverage, it may be at higher rates or reduced coverage, which could affect the customer acceptance of these products, reduce our revenues or increase our credit losses.

**Changes in trade regulations, currency fluctuations and other factors beyond our control could affect our business.**

A significant portion of our inventory is manufactured overseas and in Mexico. Changes in trade regulations, currency fluctuations or other factors beyond our control may increase the cost of items we purchase or create shortages of these items, which in turn could have a material adverse effect on our results of operations and financial condition. Conversely, significant reductions in the cost of these items in U.S. dollars may cause a significant reduction in the retail prices of those products, resulting in a material adverse effect on our sales, margins or competitive position. In addition, commissions earned on both our credit insurance and service maintenance agreement products could be adversely affected by changes in statutory premium rates, commission rates, adverse claims experience and other factors.

**We may be unable to protect our intellectual property rights, which could impair our name and reputation.**

We believe that our success and ability to compete depends in part on consumer identification of the name "Conn's." We have registered the trademarks "Conn's" and our logo. We intend to protect vigorously our trademark against infringement or misappropriation by others. A third party, however, could attempt to misappropriate our intellectual property in the future. The enforcement of our proprietary rights through litigation could result in substantial costs to us that could have a material adverse effect on our financial condition or results of operations.

**Any changes in the tax laws of the states of Texas and Louisiana could affect our state tax liabilities.**

From time to time, legislation has been introduced in the Texas legislature that would, among other things, remove the current exemption from franchise tax liability that limited partnerships enjoy. Currently, the Texas Legislature is not in session and its next regular session is scheduled to begin in January 2007; however, the Texas Governor has announced he will call a special session of the Texas Legislature beginning April 17, 2006 to address school finance reform mandated by the Texas Supreme Court. Legislation could be introduced that, among other things, could change the way that limited partnerships are taxed in the state of Texas; however, the outcome of any particular proposal cannot be predicted with any certainty.

**A further rise in oil and gasoline prices could affect our customers' determination to drive to our stores, and cause us to raise our delivery charges.**

A further significant increase in oil and gasoline prices could adversely affect our customers' shopping decisions and patterns. We rely heavily on our internal distribution system and our same or next day delivery policy to satisfy our customers' needs and desires, and any such significant increases could result in increased distribution charges. Such increases may not significantly affect our competitors.

**ITEM 1B. UNRESOLVED STAFF COMMENTS.**

None.

## ITEM 2. PROPERTIES.

The following summarizes the geographic location of our stores, warehouse and distribution centers and corporate facilities by major market area:

<u>Geographic Location</u>	<u>No. of Locations</u>	<u>Leased Facilities</u>	<u>Total Square Feet</u>	<u>Warehouse Square Feet</u>	<u>Leases With Options Expiring Beyond 10 Years</u>
Golden Triangle District (1).....	5	5	153,568	32,169	5
Louisiana District.....	5	5	129,890	27,200	5
Houston District.....	18	14	394,240	90,070	13
San Antonio/Austin District.....	13	13	379,330	83,982	12
Corpus Christi.....	1	1	51,670	14,300	1
South Texas.....	2	2	55,660	8,435	2
Dallas District.....	12	10	351,243	79,245	10
Store Totals.....	56	50	1,515,601	335,401	48
Warehouse/Distribution Centers.....	6	3	703,453	703,453	1
Service Centers.....	5	3	191,932	133,636	1
Corporate Offices.....	1	1	106,783	25,000	1
Total.....	68	57	2,517,769	1,197,490	51

(1) Includes one store in Lake Charles, Louisiana.

## ITEM 3. LEGAL PROCEEDINGS.

We are involved in routine litigation incidental to our business from time to time. 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 their proceedings cannot be predicted with certainty, and changes in facts and circumstances could impact our estimate of reserves for litigation.

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

There were no matters submitted to a vote of security holders during the fourth quarter of fiscal 2006.

## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, AND RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

#### What is the principal market for our common stock?

The principal market for our common stock is the NASDAQ National Market. Our common stock is listed on the NASDAQ National Market under the symbol "CONN." Information regarding the high and low sales prices for our common stock for each quarterly period since our initial public offering as reported on NASDAQ is summarized as follows:

	High	Low
Quarter ended April 30, 2004.....	\$ 18.08	\$ 14.50
Quarter ended July 31, 2004.....	\$ 19.18	\$ 15.35
Quarter ended October 31, 2004.....	\$ 16.82	\$ 13.79
Quarter ending January 31, 2005.....	\$ 18.33	\$ 14.37
Quarter ended April 30, 2005.....	\$ 19.70	\$ 15.29
Quarter ended July 31, 2005.....	\$ 27.51	\$ 16.69
Quarter ended October 31, 2005.....	\$ 29.80	\$ 23.20
Quarter ended January 31, 2006.....	\$ 44.93	\$ 28.68

#### How many common stockholders do we have?

As of March 27, 2006, we had approximately 57 common stockholders of record and an estimated 6,400 beneficial owners of our common stock.

#### Did we declare any cash dividends in fiscal 2005 or fiscal 2006?

No cash dividends were paid in fiscal 2005 or 2006. We do not anticipate paying dividends in the foreseeable future. Any future payment of dividends will be at the discretion of the Board of Directors and will depend upon our results of operations, financial condition, cash requirements and other factors deemed relevant by the Board of Directors, including the terms of our indebtedness. Provisions in agreements governing our long-term indebtedness restrict the amount of dividends that we may pay to our stockholders. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources."

#### Has the Company had any sales of unregistered securities during the last year?

The Company has had no sales of unregistered securities during fiscal 2006.

## ITEM 6. SELECTED FINANCIAL DATA.

	Year Ended July 31, 2001	Six Months Ended January 31, 2002	Twelve	Years Ended January 31,			
			Months Ended January 31, 2002 (unaudited)	2003	2004	2005	2006
<b>Statement of Operations (1):</b>							
(dollars and shares in thousands, except per share amounts)							
Total revenues.....	\$327,257	\$206,896	\$378,525	\$445,973	\$499,310	\$567,092	\$702,422
Operating expense:							
Cost of goods sold, including warehousing and occupancy cost.....	201,963	127,543	233,226	276,956	317,712	359,710	453,374
Selling, general and administrative expense.....	92,194	58,630	106,949	125,712	135,174	152,900	181,631
Provision for bad debts.....	1,734	1,286	2,406	4,125	4,657	5,637	3,769
Total operating expense.....	295,891	187,459	342,581	406,793	457,543	518,247	638,774
Operating income.....	31,366	19,437	35,944	39,180	41,767	48,845	63,648
Interest expense, net and minority interest.....	3,754	2,940	4,855	7,237	4,577	2,477	400
Earnings before income taxes.....	27,612	16,497	31,089	31,943	37,190	46,368	63,248
Provision for income taxes.....	9,879	5,944	11,130	11,342	12,850	16,243	22,067
Net income from continuing operations.....	17,733	10,553	19,959	20,601	24,340	30,125	41,181
Discontinued operations, net of tax.....	(546)	-	(389)	-	-	-	-
Net income.....	17,187	10,553	19,570	20,601	24,340	30,125	41,181
Less preferred stock dividends (2).....	(2,173)	(1,025)	(1,939)	(2,133)	(1,954)	-	-
Net income available for common stockholders.....	\$15,014	\$9,528	\$17,631	\$18,468	\$22,386	\$30,125	\$41,181
Earnings per common share:							
Basic.....	\$0.87	\$0.56	\$1.03	\$1.10	\$1.26	\$1.30	\$1.76
Diluted.....	\$0.87	\$0.55	\$1.01	\$1.10	\$1.22	\$1.27	\$1.70
Average common shares outstanding:							
Basic.....	17,169	17,025	17,060	16,724	17,726	23,192	23,412
Diluted.....	17,194	17,327	17,383	16,724	18,335	23,754	24,192
<b>Other Financial Data:</b>							
Stores open at end of period.....	32	36	36	42	45	50	56
Same store sales growth (3).....	10.3%	16.7%	15.6%	1.3%	2.6%	3.6%	16.9%
Inventory turns (4).....	5.9	7.5	6.8	6.6	6.5	6.0	6.6
Gross margin percentage (5).....	38.3%	38.4%	38.4%	37.9%	36.4%	36.6%	35.5%
Operating margin (6).....	9.6%	9.4%	9.5%	8.8%	8.4%	8.6%	9.1%
Return on average equity (7).....	36.7%	35.9%	34.9%	28.3%	19.5%	16.4%	18.5%
Capital expenditures.....	\$14,833	\$10,551	\$15,547	\$15,070	\$9,401	\$19,619	\$18,490
<b>Balance Sheet Data:</b>							
Working capital.....	\$40,752	\$45,546	\$45,546	\$69,984	\$115,366	\$148,074	\$179,496
Total assets.....	134,425	145,644	145,644	181,798	234,760	268,792	341,995
Total debt.....	31,445	38,750	38,750	51,992	14,512	10,532	136
Preferred stock.....	15,400	15,226	15,226	15,226	-	-	-
Total stockholders' equity.....	54,879	62,860	62,860	82,669	166,590	200,802	245,284

- (1) Information excludes the operations of the rent-to-own division that was sold in February, 2001.
- (2) Dividends were not actually declared or paid until 2004, but are presented for purposes of earnings per share calculations.
- (3) 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 period. Sales from closed stores have been removed from each period. Sales from relocated stores have been included in each period because each such store was relocated within the same general geographic market. Sales from expanded stores have been included in each period.
- (4) Inventory turns are defined as the cost of goods sold, excluding warehousing and occupancy cost, divided by the average of the beginning and ending product inventory, excluding consigned goods; information for the six months ended January 31, 2002 has been annualized for comparison purposes.
- (5) Gross margin percentage is defined as total revenues less cost of goods and parts sold, including warehousing and occupancy cost, divided by total revenues.
- (6) Operating margin is defined as operating income divided by total revenues.
- (7) Return on average equity is calculated as current period net income from continuing operations divided by the average of the beginning and ending equity; information for the six months ended January 31, 2002 has been annualized for comparison purposes.

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

### Forward-Looking Statements

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

- the success of our growth strategy and plans regarding opening new stores and entering adjacent and new markets, including our plans to continue expanding into the Dallas/Fort Worth Metroplex, and South Texas;
- our intention to update or expand existing stores;
- our ability to obtain capital for required capital expenditures and costs related to the opening of new stores or to update or expand existing stores;
- our cash flows from operations, borrowings from our revolving line of credit and proceeds from securitizations to fund our operations, debt repayment and expansion;
- rising interest rates may increase our cost of borrowings or reduce securitization income;
- 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 radio, home networking devices and other new products, and our ability to capitalize on such growth;
- the potential for price erosion or lower unit sales points that could result in declines in revenues;
- increasing oil and gas prices that could adversely affect our customers' shopping decisions and patterns;
- both short-term and long-term impact of adverse weather conditions (e.g. hurricanes) that could result in volatility in our revenues and increased expenses and casualty losses;
- changes in laws and regulations and/or interest, premium and commission rates allowed by regulators on our credit, credit insurance and service maintenance agreements as allowed by those laws and regulations;
- our relationships with key suppliers;
- the adequacy of our distribution and information systems and management experience to support our expansion plans;
- the accuracy of our expectations regarding competition and our competitive advantages;
- the potential for market share erosion that could result in reduced revenues;
- the accuracy of our expectations regarding the similarity or dissimilarity of our existing markets as compared to new markets we enter; and
- the outcome of litigation affecting our business.

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

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

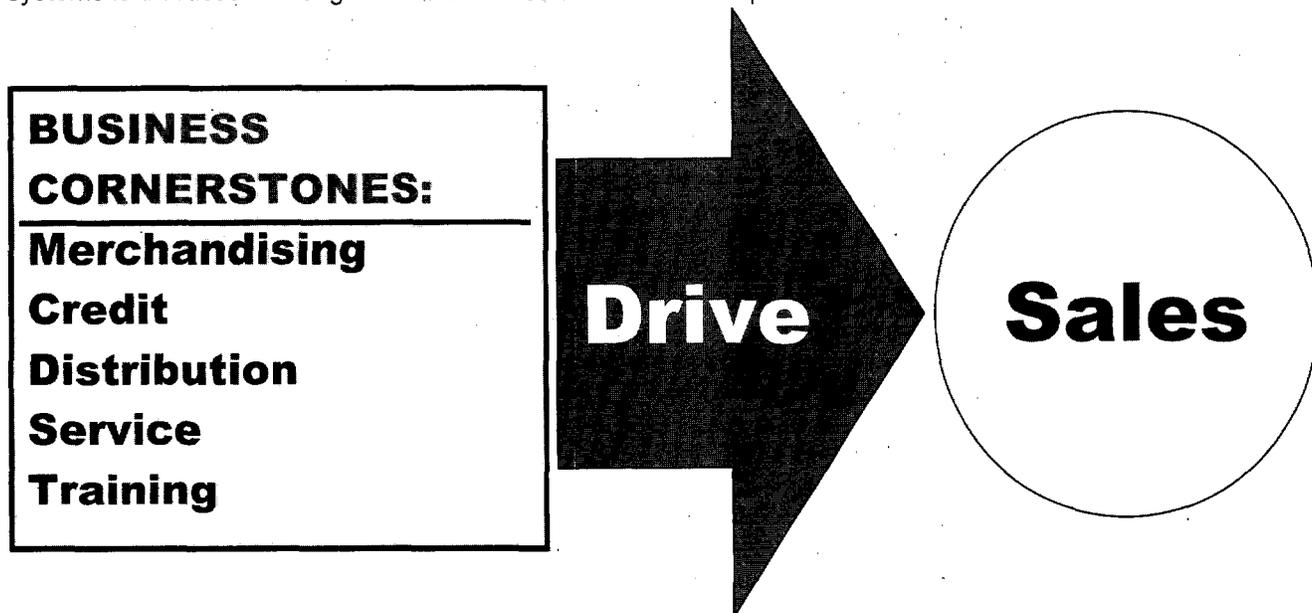
All forward-looking statements attributable to us, or to persons acting on our behalf, are expressly qualified in their entirety by these cautionary statements.

### General

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

Through our 56 retail stores, we provide products and services to our customers in six primary market areas, including Houston, San Antonio/Austin, Dallas/Fort Worth, southern Louisiana, Southeast Texas, and South Texas. Products and services offered through retail sales outlets include major home appliances, consumer electronics, home office equipment, lawn and garden products, mattresses, furniture, service maintenance agreements, customer credit programs, including installment and revolving credit account services, and various credit insurance products. These activities are supported through our extensive service, warehouse and distribution system. Our stores bear the "Conn's" name, after our founder's family, and deliver the same products and services to our customers. All of our stores follow the same procedures and methods in managing their operations. The Company's management evaluates performance and allocates resources based on the operating results of the retail stores and considers the credit programs, service contracts and distribution system to be an integral part of the Company's retail operations.

Presented below is a diagram setting forth our five cornerstones which represent, in our view, the five components of our sales goal – strong merchandising systems, state of the art credit options for our customers, an extensive warehousing and distribution system, a service system to support our customers needs beyond the product warranty periods, and our uniquely, well-trained employees in each area. Each of these systems combine to create a "nuts and bolts" support system for our customers needs and desires. Each of these systems is discussed at length in the Business section of this report.



We, of course, derive a large part of our revenue from our product sales. However, unlike many of our competitors, we provide in-house credit options for our customers' product purchases. In the last three years, we have financed, on average, approximately 57% of our retail sales through these programs. In turn, we finance (convert to cash) substantially all of our customer receivables from these credit options through an

asset-backed securitization facility. See "Business – Finance Operations" for a detailed discussion of our in-house credit programs. 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 to fund such purchases. We transfer our receivables, consisting of retail installment contracts and revolving accounts extended to our customers, to the issuer in exchange for cash and subordinated securities.

While our warehouse and distribution system does not directly generate revenues, other than the fees paid by our customers for delivery and installation of the products to their homes, it is our extra, "value-added" program that our existing customers have come to rely on, and our new customers are hopefully sufficiently impressed with to become repeat customers. We derive revenues from our repair services on the products we sell. Additionally, acting as an agent for unaffiliated companies, we sell credit insurance to protect our customers from credit losses due to death, disability, involuntary unemployment and damage to the products they have purchased; to the extent they do not already have it.

## Executive Overview

This overview is intended to provide an executive-level overview of our operations for our fiscal year ended January 31, 2006. A detailed explanation of the changes in our operations for the fiscal year ended January 31, 2006 as compared to the prior year is included beginning on page 36. Following are significant financial items in managements view:

- Our revenues for the fiscal year ended January 31, 2006 increased by 23.9 percent, or \$135.3 million, from fiscal year 2005 to \$702.4 million due to sales growth, primarily from existing stores, and increased securitization income. Our same store sales product growth rate for the fiscal year ended January 31, 2006 was 16.9%, versus 3.6% for fiscal 2005. The improvement in same store sales growth was due primarily to improved execution at the store level and effective sales promotions. (Also see "Operational Changes and Outlook.")
- During the last half of fiscal year 2006, two hurricanes; Katrina and Rita, hit the Gulf Coast. These storms significantly impacted our operations by:
  - temporary closing of our Louisiana, South East Texas, Corpus Christi and Houston stores and related distribution operations for limited periods of time,
  - positively impacting Net sales as customers in the affected areas replaced appliances and other household products damaged as a result of the storms,
  - disrupting credit collection efforts while we were displaced from our corporate headquarters as a result of Hurricane Rita, causing a short-term increase in the credit portfolio's delinquency statistics and resulting in a reduction of Finance charges and other and an increase in Bad debt expense, and
  - causing us to incur expenses related to the relocation of our corporate office functions and losses related to damaged merchandise and facilities, net of insurance proceeds.
- Same store sales benefited from the effects of the hurricanes. Appliance sales accounted for the majority of the increase in total same stores sales during the period due in part to our customers' need to replace items damaged by the storms. We believe same store sales, adjusted for our estimate of the impact of the hurricanes, grew approximately 12% for the year ended January 31, 2006.
- Our entry into the Dallas/Fort Worth and the South Texas markets had a positive impact on our revenues. Approximately \$75.9 million of our product sales for the year ended January 31, 2006, came from the opening of twelve new stores in these markets, since February 2004. Our plans provide for the opening of additional stores in existing markets during the balance of fiscal 2007 as we focus on opportunities in markets in which we have existing infrastructure.
- 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 that extend beyond one year, relative to gross product sales volume. For the fiscal years ended January 31, 2005 and 2006, \$29.0 million and

\$33.9 million, respectively, in gross product sales were financed by extended deferred interest and "same as cash" plans. These extended term promotional programs were not offered broadly until April, 2004. We expect to continue to offer this type of extended term promotional credit in the future.

- During the year ended January 31, 2006, pretax income was reduced by \$1.0 million to reflect our estimate of expected losses due to increased delinquencies from Hurricane Rita and a temporary increase in bankruptcy filings. The increase in bankruptcy filings is as a result of the new bankruptcy law that took effect October 17, 2005, prompting consumers to file for bankruptcy protection before the new law went into effect. The \$1.0 million charge to earnings reduced Finance charges and other by \$895,000 and increased Bad debt expense by \$105,000.
- Our gross product margin was 35.5% for fiscal year 2006, a decrease from 36.6% in fiscal 2005, primarily as a result of a change in our revenue mix as Product sales grew faster than Service revenues and Finance charges and other. Also, reduced insurance sales penetration negatively impacted our gross margin.
- Our operating margin increased to 9.1% from 8.6% in fiscal 2005. In fiscal year 2006, we decreased SG&A expense as a percent of revenues to 25.8% from 27.0% when compared to the prior year, primarily from decreases in payroll and payroll related expenses and net advertising expense as a percent of revenues. Partially offsetting these reductions were increased general liability insurance expense and expenses incurred due to Hurricane Rita of approximately \$907,000, net of estimated insurance proceeds. Additionally, our operating margin benefited from a decrease in the Provision for bad debts as a percent of revenues from 1.0% to 0.5%.
- Operating cash flows were \$64.3 million for fiscal 2006. Our operating cash flows increased as a result of increased net income, improved funding under our asset-backed securitization and vendor and federal employment and income tax payment deferrals granted because of the hurricanes. Most of the payments deferred will be paid during the three month period ended April 30, 2006.
- Our pretax income for fiscal 2006 increased by 36.4% or approximately \$16.8 million, from fiscal 2005 to \$63.2 million. The increase was driven largely by the increase in sales with additional benefit from improved expense leverage, as Selling, general and administrative expenses did not grow as fast as revenues.

### **Operational Changes and Outlook**

We have implemented, continued increased focus on or modified several initiatives in fiscal 2006 that we believe will positively impact our future operating results, including:

- A reorganization of our retail management team, including strengthening the district management team in the Dallas/Fort Worth market;
- Successfully increasing the sales force by adding approximately 13% more sales associates per store, resulting in incremental sales volume;
- Implementation of call centers in the stores, emphasizing regular, consistent contact with our customers;
- Increased emphasis on the sales of furniture, and additional product lines added to this category; and
- Promoting flat panel technology in our stores as the price point becomes more affordable for our customers.

Our sales during the last five months of fiscal 2006 benefited from the impact of Hurricanes Katrina and Rita. This impact could affect future same store sales due to:

- The acceleration of the sale of essential appliances in the affected markets disrupting the normal replacement cycle for these items; and
- The same store sales reported for the impacted markets being elevated to a level that might not be duplicated.

While our credit portfolio delinquency statistics were still negatively impacted by the effects of the hurricanes at January 31, 2006, we anticipate the portfolio performance returning to historical levels as we continue to work with the customers impacted by these events.

During the year, we opened four new stores in the Dallas/Fort Worth market, one in Harlingen, Texas and one in San Antonio, Texas. We continue to be satisfied with the results in the Dallas/Fort Worth market and will continue to expand the number of stores in that market. We added additional distribution capability during the year by opening our 140,000 square foot distribution center in Dallas, and increased our service center capabilities in Dallas by converting our previous distribution center to a full-time service center. Our new Harlingen store now joins a store in McAllen, Texas, opened in early September 2004, forming our South Texas market. We believe that this market is substantially underserved and provides great growth potential for our company. We have several other locations in Texas and Louisiana 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.

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

### **Application of Critical Accounting Policies**

In applying the accounting policies that we use to prepare our consolidated financial statements, we necessarily make accounting estimates that affect our reported amounts of assets, liabilities, revenues and expenses. Some of these accounting estimates require us to make assumptions about matters that are highly uncertain at the time we make the accounting estimates. We base these assumptions and the resulting estimates on authoritative pronouncements, historical information and other factors that we believe to be reasonable under the circumstances, and we evaluate these assumptions and estimates on an ongoing basis. We could reasonably use different accounting estimates, and changes in our accounting estimates could occur from period to period, with the result in each case being a material change in the financial statement presentation of our financial condition or results of operations. We refer to accounting estimates of this type as "critical accounting estimates." We believe that the critical accounting estimates discussed below are among those most important to an understanding of our consolidated financial statements as of January 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 Statement of Financial Accounting Standards ("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 cash flows resulting entirely from the interest on the security. The gain or loss recognized on these transactions is based on our best estimates of key assumptions, including forecasted credit losses, 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), our interest in securitized assets would have been reduced by \$4.7 million as of January 31, 2006, which may have an adverse effect on earnings. We recognize income from our interest in these transferred accounts based on the difference between the interest earned on customer accounts and the costs associated with financing and servicing the transferred accounts, less a provision for bad debts associated with the transferred assets. This income is recorded as "Finance charges and other" in our consolidated statement of operations. If we had assumed a 10% increase in the assumption used for developing the reserve for doubtful accounts on the books of the QSPE, the impact to recorded "Finance charges and other" would have been a reduction in revenues and pretax income of \$1.2 million.

*Deferred Tax Assets.* We have significant net deferred tax assets (approximately \$5.5 million as of January 31, 2006), which are subject to periodic recoverability assessments. Realization of our net deferred tax assets may be dependent upon whether we achieve projected future taxable income. Our estimates regarding future profitability may change due to future market conditions, our ability to continue to execute at historical levels and our ability to continue our growth plans. These changes, if any, may require material adjustments to these deferred tax asset balances. For example, if we had assumed that the future tax rate at which these deferred items would reverse was 34.1% rather than 35.1%, we would have reduced the net deferred tax asset and net income by approximately \$94,000.

*Intangible Assets.* We have significant intangible assets related primarily to goodwill. The determination of related estimated useful lives and whether or not these assets are impaired involves significant judgments. Effective with the implementation of SFAS 142, we ceased amortizing goodwill and began testing potential impairment of this asset annually based on judgments regarding ongoing profitability and cash flow of the underlying assets. Changes in strategy or market conditions could significantly impact these judgments and require adjustments to recorded asset balances. For example, if we had reason to believe that our recorded goodwill had become impaired due to decreases in the fair market value of the underlying business, we would have to take a charge to income for that portion of goodwill that we believe is impaired. Our goodwill balance at January 31, 2005 and 2006 was \$9.6 million.

*Property, Plant and Equipment.* Our accounting policies regarding land, buildings, and equipment include judgments regarding the estimated useful lives of such assets, the estimated residual values to which the assets are depreciated, and the determination as to what constitutes increasing the life of existing assets. These judgments and estimates may produce materially different amounts of depreciation and amortization expense than 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 if the anticipated cash flows associated with the assets are not realized. In addition, the actual life of the asset and residual value may be different from the estimates used to prepare financial statements in prior periods.

*Revenue Recognition.* Revenues from the sale of retail products are recognized at the time the product is delivered to the customer. Such revenues are recognized net of any adjustments for sales incentive offers such as discounts, coupons, rebates, or other free products or services. We sell service maintenance agreements and credit insurance contracts on behalf of unrelated third parties. For contracts where the third parties are the obligor on the contract, commissions are recognized in revenues at the time of sale, and in the case of retrospective commissions, based on claims experience, at the time that they are earned. When we sell service maintenance 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 direct obligor 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 and 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 amounts of service maintenance agreement revenue deferred at January 31, 2005 and 2006 were \$3.9 million and \$3.6 million, respectively, and are included in "Deferred revenue" in the accompanying balance sheets. The amounts of service maintenance agreement revenue recognized for the fiscal years ended January 31, 2004, 2005 and 2006 were \$4.5 million, \$5.0 million and \$5.0 million, respectively.

*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.

*Recent Accounting Pronouncements.* In December 2004, Statement of Financial Accounting Standards No. 123R, *Share-Based Payment*, was issued. 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. Additionally, the statement provides multiple options for adopting the requirements of the standard. We are required to implement the provisions of this statement effective February 1, 2006, and intend to elect to retrospectively adjust prior year results for comparison purposes. We are required under existing accounting standards to provide supplemental disclosure in the footnotes to our financial statements as if our financial statements had been prepared using the fair value method of accounting for stock based compensation. See Note 1 to our financial statements for additional information.

*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. 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.

## Results of Operations

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

	Years ended January 31,		
	2004	2005	2006
<b>Revenues:</b>			
Product sales.....	80.6 %	79.6 %	81.1 %
Service maintenance agreement commissions (net).....	4.0	4.2	4.4
Service revenues.....	3.7	3.3	2.9
Total net sales.....	88.3	87.1	88.4
Finance charges and other.....	11.7	12.9	11.6
Total revenues.....	100.0	100.0	100.0
<b>Cost and expenses:</b>			
Cost of goods sold, including warehousing and occupancy costs.....	62.8	62.6	63.8
Cost of parts sold, including warehousing and occupancy costs.....	0.8	0.8	0.8
Selling, general and administrative expense.....	27.1	27.0	25.8
Provision for bad debts.....	0.9	1.0	0.5
Total costs and expenses.....	91.6	91.4	90.9
<b>Operating income.....</b>	<b>8.4</b>	<b>8.6</b>	<b>9.1</b>
<b>Interest expense (including minority interest).....</b>	<b>0.9</b>	<b>0.4</b>	<b>0.1</b>
<b>Earnings before income taxes.....</b>	<b>7.5</b>	<b>8.2</b>	<b>9.0</b>
<b>Provision for income taxes</b>			
Current.....	2.6	2.9	3.3
Deferred.....	-	-	(0.2)
<b>Total provision for income taxes.....</b>	<b>2.6</b>	<b>2.9</b>	<b>3.1</b>
<b>Net income.....</b>	<b>4.9 %</b>	<b>5.3 %</b>	<b>5.9 %</b>

In reviewing the percentages reflected in the above table, we noted that the following trends in our operations developed within the last twelve months.

- The increase in cost of goods sold as a percentage of total revenues reflects the shift in revenue mix as product sales grew faster than service revenues and finance charges and other. Cost of products sold was 78.7% of net product sales in the 2005 period and 78.6% in the 2006 period.
- The decline in selling, general and administrative 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, that were partially offset by increased general liability insurance expense and higher expenses incurred due to Hurricane Rita.
- The declining trend in interest expense as a percentage of total revenues is a function of continuing to generate positive cash flow, the pay-off of debt with our IPO proceeds in fiscal year 2004 and the impact of expiring interest rate swap agreements.

The presentation of our 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 of merchandising our products, including amounts related to purchasing the product and a portion of our advertising cost, in selling, general and administrative expense. It is our understanding that other retailers may include such costs as part of cost of goods sold.

The following table presents certain operations information in dollars and percentage changes from year to year:

### Analysis of Consolidated Statements of Operations

(in thousands except percentages)

	Years Ended January 31,			2005 vs. 2004		2006 vs. 2005	
	2004	2005	2006	Incr/(Decr)		Incr/(Decr)	
				Amount	Pct	Amount	Pct
<b>Revenues</b>							
Product sales.....	\$402,579	\$451,560	\$569,877	\$48,981	12.2 %	\$118,317	26.2 %
Service maintenance agreement commissions (net).....	20,074	23,950	30,583	3,876	19.3	6,633	27.7
Service revenues.....	18,265	18,725	20,278	460	2.5	1,553	8.3
<b>Total net sales</b> .....	<b>440,918</b>	<b>494,235</b>	<b>620,738</b>	<b>53,317</b>	<b>12.1</b>	<b>126,503</b>	<b>25.6</b>
Finance charges and other.....	58,392	72,857	81,684	14,465	24.8	8,827	12.1
<b>Total revenues</b> .....	<b>499,310</b>	<b>567,092</b>	<b>702,422</b>	<b>67,782</b>	<b>13.6</b>	<b>135,330</b>	<b>23.9</b>
Cost of goods and parts sold.....	317,712	359,710	453,374	41,998	13.2	93,664	26.0
<b>Gross Profit</b> .....	<b>181,598</b>	<b>207,382</b>	<b>249,048</b>	<b>25,784</b>	<b>14.2</b>	<b>41,666</b>	<b>20.1</b>
<b>Gross Margin</b> .....	<b>36.4%</b>	<b>36.6%</b>	<b>35.5%</b>				
Selling, general and administrative expense.....	135,174	152,900	181,631	17,726	13.1	28,731	18.8
Provision for bad debts.....	4,657	5,637	3,769	980	21.0	(1,868)	(33.1)
<b>Operating income</b> .....	<b>41,767</b>	<b>48,845</b>	<b>63,648</b>	<b>7,078</b>	<b>16.9</b>	<b>14,803</b>	<b>30.3</b>
<b>Operating Margin</b> .....	<b>8.4%</b>	<b>8.6%</b>	<b>9.1%</b>				
Interest expense.....	4,577	2,359	400	(2,218)	(48.5)	(1,959)	(83.0)
Minority interest in limited partnership.....	-	118	-	118		(118)	
<b>Pretax income</b> .....	<b>37,190</b>	<b>46,368</b>	<b>63,248</b>	<b>9,178</b>	<b>24.7</b>	<b>16,880</b>	<b>36.4</b>
Income taxes.....	12,850	16,243	22,067	3,393	26.4	5,824	35.9
<b>Net Income</b> .....	<b>24,340</b>	<b>30,125</b>	<b>41,181</b>	<b>5,785</b>	<b>23.8</b>	<b>11,056</b>	<b>36.7</b>
<b>Less preferred dividends</b> .....	<b>1,954</b>	<b>-</b>	<b>-</b>	<b>(1,954)</b>	<b>(100.0)</b>	<b>-</b>	<b>-</b>
<b>Net income available for common stockholders</b> .....	<b>\$22,386</b>	<b>\$30,125</b>	<b>41,181</b>	<b>\$7,739</b>	<b>34.6 %</b>	<b>\$11,056</b>	<b>36.7 %</b>

Refer to the above Analysis of Consolidated Statements of Operations in condensed form while reading the operations review on a year by year basis.

### Year Ended January 31, 2005 Compared to the Year Ended January 31, 2006

**Revenues.** Total revenues increased by \$135.3 million, or 23.9%, from \$567.1 million for the year ended January 31, 2005 to \$702.4 million for the year ended January 31, 2006. The increase was attributable to increases in net sales of \$126.5 million, or 25.6%, and \$8.8 million, or 12.1%, in finance charges and other revenue.

The \$126.5 million increase in net sales was made up of the following:

- a \$75.8 million increase resulted from a same store sales increase of 16.9%. Appliance sales accounted for the majority of the increase and were significantly impacted by our customers' need to replace items damaged as a result of Hurricanes Katrina and Rita. After adjusting for our estimate of the impact of the storms, we believe same store sales increased approximately 12%, with appliance, electronics, track and furniture sales being the biggest contributors. 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 \$1.4 million, (offsetting this increase is a decrease in retrospective commissions which is reflected in Finance charges and other),
- a \$49.8 million increase generated by twelve retail locations that were not open for twelve consecutive months in each period, net of reductions related to the closing of one location,

- a \$644,000 decrease resulted from an increase in discounts on promotional credit sales, and
- a \$1.6 million increase resulted from an increase in service revenues.

The components of the \$126.5 million increase in net sales were a \$118.3 million increase in product sales and an \$8.2 million net increase in service maintenance agreement commissions and service revenues. The \$118.3 million increase in product sales resulted from the following:

- approximately \$82.6 million was attributable to increases in unit sales, due to increased appliances, track, furniture, and consumer electronics sales, and
- approximately \$35.7 million was attributable to increases in unit price points. The price point impact was driven primarily by:
  - consumers selecting higher priced consumer electronics products, as the new technology becomes more affordable;
  - consumers selecting higher priced appliance products, including high-efficiency washers and dryers and stainless kitchen appliances, and
  - higher prices on appliances in general.

The following table presents the makeup of net sales by product category in each period, 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	Years Ended January 31,				Percent Increase
	2005		2006		
	Amount	Percent	Amount	Percent	
	(dollars in thousands)				
Major home appliances .....	\$ 168,962	34.2 %	\$ 223,651	36.0 %	32.4 % (1)
Consumer electronics .....	154,880	31.3	186,679	30.1	20.5 (2)
Track .....	85,644	17.3	100,154	16.1	16.9 (2)
Delivery .....	7,605	1.5	9,870	1.6	29.8 (2)
Lawn and garden .....	13,710	2.8	17,083	2.8	24.6 (2)
Bedding .....	10,262	2.1	13,126	2.1	27.9 (2)
Furniture .....	7,182	1.5	15,313	2.5	113.2 (3)
Other .....	3,315	0.7	4,001	0.6	20.7 (2)
Total product sales .....	<u>451,560</u>	<u>91.4</u>	<u>569,877</u>	<u>91.8</u>	26.2
Service maintenance agreement					
commissions .....	23,950	4.8	30,583	4.9	27.7 (2)
Service revenues .....	18,725	3.8	20,278	3.3	8.3
Total net sales .....	<u>\$ 494,235</u>	<u>100.0 %</u>	<u>\$ 620,738</u>	<u>100.0 %</u>	25.6 %

(1) In addition to strong overall sales growth, appliance sales benefited from our customers' needs after the hurricanes.

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

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

Revenue from Finance charges and other increased by approximately \$8.8 million, or 12.1%, from \$72.9 million for the year ended January 31, 2005 to \$81.7 million for the year ended January 31, 2006. This increase in revenue resulted primarily from increases in securitization income of \$9.6 million, a \$1.0 million decrease in service maintenance agreement retrospective commissions and a net increase in insurance commissions and other revenues of \$210,000. The increase in securitization income is attributable to higher product sales and increases in our retained interest in assets transferred to the QSPE, due primarily to increases in the transferred balances. Partially offsetting the securitization income increases was a reduction of \$895,000 for estimated losses resulting from increased bankruptcy filings by our customers prior to October 17, 2005, the effective date of the new bankruptcy law and our estimate of expected additional loan losses due to the impact of Hurricane Rita.

*Cost of Goods Sold.* Cost of goods sold, including warehousing and occupancy cost, increased by \$92.9 million, or 26.2%, from \$355.2 million for the year ended January 31, 2005 to \$448.1 million for the year ended January 31, 2006. This increase was consistent with the 26.2% increase in net product sales during the year ended January 31, 2006. Cost of products sold was 78.7% of net product sales in the 2005 period and 78.6% in the 2006 period.

*Cost of Service Parts Sold.* Cost of service parts sold, including warehousing and occupancy cost, increased approximately \$758,000, or 16.7%, for the year ended January 31, 2006 as compared to the year ended January 31, 2005, due to increases in parts sales.

*Selling, General and Administrative Expense.* While Selling, general and administrative expense increased by \$28.7 million, or 18.8%, from \$152.9 million for the year ended January 31, 2005 to \$181.6 million for the year ended January 31, 2006, it decreased as a percentage of total revenue from 27.0% to 25.8%. 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, that were partially offset by increased general liability insurance expense and higher expenses incurred due to Hurricane Rita of approximately \$907,000, net of estimated insurance proceeds, including expenses related to relocation of the corporate office functions and losses related to damaged merchandise and facility damage.

*Provision for Bad Debts.* The provision for bad debts on receivables retained by the Company and not transferred to the QSPE and other non-credit portfolio receivables decreased by \$1.9 million, or 33.1%, during the year ended January 31, 2006 as compared to the year ended January 31, 2005, primarily as a result of changes in the loss history and provision adjustments based on favorable loss experience during the last twelve months, and revised loss allocations between receivables retained by us and those transferred to the QSPE, which were offset in Finance charges and other. Partially offsetting the bad debt expense decrease was a charge of \$105,000 for estimated losses resulting from increased bankruptcy filings by our customers prior to October 17, 2005, the effective date of the new bankruptcy law and expected additional loan losses due to the impact of Hurricane Rita on our customers. See Note 2 to the financial statements for information regarding the performance of the credit portfolio.

*Interest Expense, net.* Net interest expense decreased by \$2.0 million, or 83.0%, from \$2.4 million for the year ended January 31, 2005 to \$400,000 for the year ended January 31, 2006. The net decrease in interest expense was attributable to the following factors:

- expiration of \$20.0 million in our interest rate hedges and the discontinuation of hedge accounting for derivatives resulted in a net decrease in interest expense of approximately \$856,000; and
- the deconsolidation of SRDS (previously consolidated as a VIE according to FIN 46) resulted in a decrease of interest expense of \$759,000,

The remaining decrease in interest expense of \$385,000 resulted from lower average outstanding debt balances and higher interest income from invested funds.

*Minority Interest.* As a result of FIN 46, for the year ended January 31, 2005, we eliminated the pretax operating profit contributed from the consolidation of SRDS through the minority interest line item in our consolidated statement of operations (see Note 1 of Notes to the Financial Statements).

*Provision for Income Taxes.* The provision for income taxes increased by \$5.9 million, or 36.0%, from \$16.2 million for the year ended January 31, 2005 to \$22.1 million for the year ended January 31, 2006, consistent with the increase in pretax income of 36.1%.

*Net Income.* As a result of the above factors, Net income increased \$11.1 million, or 36.7%, from \$30.1 million for the year ended January 31, 2005 to \$41.2 million for the year ended January 31, 2006.

## **Year Ended January 31, 2004 Compared to the Year Ended January 31, 2005**

*Revenues.* Total revenues increased by \$67.8 million, or 13.6%, from \$499.3 million for the year ended January 31, 2004 to \$567.1 million for the year ended January 31, 2005. The increase was attributable to

increases in net sales of \$53.3 million, or 12.1%, and \$14.5 million, or 24.8%, in finance charges and other revenue.

The \$53.3 million increase in net sales was made up of the following:

- a \$14.8 million increase resulted from a same store sales increase of 3.6%.
- a \$40.5 million increase generated by nine retail locations that were not open for twelve consecutive months in each period.
- a \$2.4 million decrease resulted from an increase in discounts on promotional credit sales, and
- a \$460,000 increase resulted from an increase in service revenues.

The components of the \$53.3 million increase in net sales were a \$49.0 million increase in product sales and a \$4.3 million net increase in service maintenance agreement commissions and service revenues. The \$49.0 million increase in product sales resulted from the following:

- approximately \$18.0 million was attributable to increases in unit sales, due to increased appliances, mattresses and track sales, and
- approximately \$31.0 million was attributable to increases in unit price points. The price point impact was driven primarily by consumers selecting higher priced products as new technology prices fall and become more affordable.

The following table presents the makeup of net sales by product category in each period, 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	Years Ended January 31,				Percent Increase
	2004		2005		
	Amount	Percent	Amount	Percent	
	(dollars in thousands)				
Major home appliances .....	\$ 159,401	36.1 %	\$ 168,962	34.2 %	6.0 %
Consumer electronics .....	139,417	31.6	154,880	31.3	11.1
Track.....	70,031	15.9	85,644	17.3	22.3 (1)
Delivery.....	6,726	1.5	7,605	1.5	13.1
Lawn and garden .....	11,505	2.6	13,710	2.8	19.2 (2)
Bedding .....	6,441	1.5	10,262	2.1	59.3 (2)
Furniture .....	5,712	1.3	7,182	1.5	25.7 (3)
Other .....	3,346	0.8	3,315	0.7	(0.9)
Total product sales .....	402,579	91.3	451,560	91.4	12.2
Service maintenance agreement					
commissions .....	20,074	4.6	23,950	4.8	19.3
Service revenues .....	18,265	4.1	18,725	3.8	2.5
Total net sales .....	<u>\$ 440,918</u>	<u>100.0 %</u>	<u>\$ 494,235</u>	<u>100.0 %</u>	12.1 %

- (1) Emphasis continues to be given to promotion of sales in the "track" area of computers, computer peripherals, portable electronics and small appliances.
- (2) The increases in lawn and garden and mattresses result from our increased emphasis placed on these relatively new product categories and the introduction of the Serta brand mattresses to our product line.
- (3) There has been significant growth in the sales of furniture, primarily recliners and other seating products. More square footage is being devoted to furniture in certain store locations as we continue to "test the market" for this product category.

Revenue from Finance charges and other increased by approximately \$14.5 million, or 24.8%, from \$58.4 million for the year ended January 31, 2004 to \$72.9 million for the year ended January 31, 2005. This increase in revenue resulted primarily from increases in securitization income of \$11.7 million, and increases in insurance

commissions and other revenues of \$2.8 million. The increase in securitization income is attributable to higher product sales and increases in our retained interest in assets transferred to the QSPE, due primarily to increases in the transferred balances.

*Cost of Goods Sold.* Cost of goods sold, including warehousing and occupancy cost, increased by \$41.5 million, or 13.2%, from \$313.6 million for the year ended January 31, 2004 to \$355.1 million for the year ended January 31, 2005. This increase primarily resulted from the 12.2% increase in net product sales as well as an increase in cost of products sold. Cost of products sold was 77.9% of net product sales in the 2004 period and 78.7% in the 2005 period. The overall increase in cost of goods sold as a percentage of product sales was primarily caused by the continued deterioration of retail price points and sales of relatively lower margin computer products growing at a more rapid rate than sales of higher margin products.

*Cost of Service Parts Sold.* Cost of service parts sold, including warehousing and occupancy cost, increased approximately \$500,000, or 11.7%, for the year ended January 31, 2005 as compared to the year ended January 31, 2004, due to increases in parts sales.

*Selling, General and Administrative Expense.* While Selling, general and administrative expense increased by \$17.7 million, or 13.1%, from \$135.2 million for the year ended January 31, 2004 to \$152.9 million for the year ended January 31, 2005, it decreased as a percentage of total revenue from 27.1% to 27.0%. The increase in total expense was primarily the result of increased sales salaries and commissions (and other payroll-related expense), delivery, occupancy and depreciation expense due to the addition of new stores and all in line with the 12.1% increase in net sales. Professional services was up 41.2% which partially reflects the effect of complying with Sarbanes/Oxley Section 404 by expending approximately \$600,000 on direct implementation, including our independent accounting firms cost incurred in testing and preparation necessary to issue its initial report, but not including our employee man hours. General liability, property and health insurance costs were up 24.3% due to additional stores, additional employees (primarily sales) and the higher exposure of being a publicly-traded company. These cost increases were partially offset by decreases in telephone, amortization, advertising and equipment lease expense.

*Provision for Bad Debts.* The provision for bad debts on receivables retained by the Company and not transferred to the QSPE and other non-credit portfolio receivables increased by \$1.0 million, or 21.1%, during the year ended January 31, 2005 as compared to the year ended January 31, 2004, primarily due to the 21.2% increase in our average outstanding balance of our credit portfolio.

*Interest Expense, net.* Net interest expense decreased by \$2.2 million, or 48.5%, from \$4.6 million for the year ended January 31, 2004 to \$2.4 million for the year ended January 31, 2005. The net decrease in interest expense was attributable to the following factors:

- the expiration of \$30.0 million of our interest rate hedges in April 2003 and the expiration of \$50.0 million of our interest rate hedges in November 2003 and the discontinuation of hedge accounting for derivatives resulted in a net decrease of \$1.4 million in interest expense from the prior period; and
- the decrease in our average outstanding debt from \$39.9 million to \$2.6 million (when ignoring the impact of FIN 46 consolidation of \$14.8 million, see below) as a result of our public offering and payoff of substantially all of our outstanding debt with the proceeds resulted in a decrease in interest expense of approximately \$1.9 million;

these decreases were offset by the following:

- the increase in interest rates in our continuing revolving debt facilities and related commitment fees of \$361,000; and
- the implementation of FIN 46 resulted in reclassification of \$759,000 in expenses previously reflected as occupancy cost in Selling, general and administrative expense to Interest expense; these reclassifications should not be necessary in the future since we are no longer subject to the provisions of FIN 46.

*Minority Interest.* As a result of FIN 46, beginning February 1, 2004, we eliminate the pretax operating profit contributed from the consolidation of SRDS through the minority interest line item in our consolidated statement of operations.

*Provision for Income Taxes.* The provision for income taxes increased by \$3.4 million, or 26.4%, from \$12.8 million for the year ended January 31, 2004 to \$16.2 million for the year ended January 31, 2005. The increase in the tax provision was directly related to the increase in pretax profits of \$9.2 million, or 24.7%. The effective tax rate attributable to continuing operations for the year ended January 31, 2005 was 35.0%, compared with 34.6% for the prior year. Taxes were comprised of federal and state rates totaling 35.5% in both periods offset by cash refunds due to return amounts being lower than estimates and adjustments of previous tax provisions in both periods.

*Net Income.* As a result of the above factors, Net income increased \$5.8 million, or 23.8%, from \$24.3 million for the year ended January 31, 2004 to \$30.1 million for the year ended January 31, 2005.

### **Impact of Inflation**

We do not believe that inflation has a material effect on our net sales or results of operations. However, a continuing significant increase in oil and gasoline prices could adversely affect our customers' shopping decisions and patterns. We rely heavily on our internal distribution system and our same or next day delivery policy to satisfy our customers' needs and desires, and any such significant increases could result in increased distribution charges. Such increases may not affect our competitors in the same manner as it affects us.

### **Seasonality and Quarterly Results of Operations**

Our business is somewhat seasonal, with a higher portion of sales and operating profit realized during the quarter that ends January 31. The fiscal quarter ending January 31 reflects the holiday selling season, the major collegiate bowl season, the National Football League playoffs and the Super Bowl. Over the four quarters of fiscal 2006, gross margins were 35.4%, 36.2%, 35.7% and 34.6%. During the same period, operating margins were 9.7%, 8.8%, 8.2% and 9.5%. A portion of the fluctuation in gross margins and operating margins is due to planned infrastructure cost additions, such as increased warehouse space and larger stores, additional personnel and systems required to absorb the significant increase in revenues that we have experienced over the last several years.

Additionally, quarterly results may fluctuate materially depending on factors such as the following:

- timing of new product introductions, new store openings and store relocations;
- sales contributed by new stores;
- increases or decreases in comparable store sales;
- adverse weather conditions;
- shifts in the timing of certain holidays or promotions; and
- changes in our merchandise mix.

Results for any quarter are not necessarily indicative of the results that may be achieved for a full year.

The following table sets forth certain unaudited quarterly statement of operations information for the eight quarters ended January 31, 2006. The unaudited quarterly information has been prepared on a consistent basis and includes all normal recurring adjustments that management considers necessary for a fair presentation of the information shown.

	2005				2006			
	Quarter Ended				Quarter Ended			
	Apr. 30	Jul. 31	Oct. 31	Jan. 31	Apr. 30	Jul. 31	Oct. 31	Jan. 31
	(dollars and shares in thousands, except per share amounts)							
Total revenues.....	\$ 134,877	\$ 136,601	\$ 132,910	\$ 162,704	\$ 158,163	\$ 164,375	\$ 173,305	\$ 206,579
Percent of total revenues.....	23.8%	24.1%	23.4%	28.7%	22.5%	23.4%	24.7%	29.4%
Gross profit.....	\$ 48,999	\$ 49,805	\$ 49,228	\$ 59,350	\$ 56,021	\$ 59,560	\$ 61,947	\$ 71,520
Gross profit as a % of total revenues.....	36.3%	36.5%	37.0%	36.5%	35.4%	36.2%	35.7%	34.6%
Operating profit.....	\$ 12,715	\$ 11,057	\$ 10,117	\$ 14,956	\$ 15,387	\$ 14,417	\$ 14,137	\$ 19,707
Operating profit as a % total revenues.....	9.4%	8.1%	7.6%	9.2%	9.7%	8.8%	8.2%	9.5%
Net income available for common stockholder.....	\$ 7,773	\$ 6,790	\$ 6,315	\$ 9,247	\$ 9,802	\$ 9,324	\$ 9,131	\$ 12,924
Net income available for common stockholder as a % of revenue.....	5.8%	5.0%	4.8%	5.7%	6.2%	5.7%	5.3%	6.3%
Outstanding shares:								
Basic.....	23,145	23,179	23,206	23,230	23,307	23,366	23,458	23,523
Diluted.....	23,749	23,801	23,681	23,764	23,856	24,114	24,286	24,512
Earnings per share:								
Basic.....	\$ 0.34	\$ 0.29	\$ 0.27	\$ 0.40	\$ 0.42	\$ 0.40	\$ 0.39	\$ 0.55
Diluted.....	\$ 0.32	\$ 0.29	\$ 0.27	\$ 0.39	\$ 0.41	\$ 0.39	\$ 0.38	\$ 0.53

### Liquidity and Capital Resources

We require capital to finance our growth as we add new stores and markets to our operations, which in turn requires additional working capital for increased receivables and inventory. We have historically 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. At January 31, 2006, we had a revolving line of credit facility with a group of lenders in the amount of \$50 million, under which we had no borrowings outstanding but utilized \$3.0 million of availability to issue letters of credit. We expect that our cash requirements for the foreseeable future, including those for our capital expenditure requirements, will be met with our available line of credit and our existing \$45.2 million in cash and cash equivalents at January 31, 2006, together with cash generated from operations. Our current plans are to grow our store base by approximately 10% a year. We expect we will invest in real estate and customer receivables to support the additional stores and same store sales growth. Depending on market conditions we may, at times, enter into sale-leaseback transactions to finance our real estate or seek alternative financing sources for new store expansions and customer receivables growth.

The following is a comparison of our statement of cash flows for our fiscal years 2005 and 2006:

The increase in cash flow from operating activities for fiscal year 2006 from fiscal year 2005 of \$64.1 million, resulted primarily from increased net income, a smaller increase in the retained interest in the asset backed securitization program and the timing of payments of accounts payable and federal income and employment taxes. Operating cash flows have been positively impacted in the amount of approximately \$18.9 million by federal income and employment tax payment deadlines being deferred until February 28, 2006 after Hurricane Rita.

Our promotional credit programs offered to certain customers provide for "same as cash" interest free periods of varying terms, generally three, six, twelve, eighteen, twenty-four or thirty-six months. These promotional accounts are eligible for securitization up to 30.0% of eligible securitized receivables. The

percentage of eligible securitized receivables represented by promotional receivables was 15.0%, 23.5% and 19.4% as January 31, 2004, 2005 and 2006, respectively. To the extent we exceed the 30.0% limit, or to the extent we have such promotional credit receivables that do not qualify for inclusion in the programs, we are required to use our other capital resources to fund the unpaid balance of the receivables for the promotional period. The weighted average promotional period was 12.5 and 11.8 months for promotional receivables outstanding as of January 31, 2005 and January 31, 2006, respectively. The weighted average remaining term on those same promotional receivables was 9.0 and 7.3 months, respectively. While overall these promotional receivables have a much shorter average weighted life than non-promotional receivables, we receive less income as a result of a reduced net interest margin used in the calculation of the gain on the sale of the receivables. As a result, the existence of the interest free extended payment terms negatively impacts the gains or losses as compared to the other receivables, and results in a decrease in our available cash.

Net cash used in investing activities was \$18.5 million for both fiscal year 2005 and fiscal year 2006. Offsetting the \$1.1 million decline in purchases of property and equipment was a \$1.1 million decline in proceeds from sales of property and equipment. Included in fiscal 2005 purchase of property and equipment was \$1.7 million of purchases by SRDS, which was consolidated in our fiscal 2005 Statement of Cash Flows. 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. We estimate that capital expenditures for the 2007 fiscal year will approximate \$25 million to \$30 million.

We lease 50 of our 56 stores, and our plans for future store locations include primarily leases, but does not exclude store ownership. Our capital expenditures for future store projects should primarily be for our tenant improvements to the property leased (including any new distribution centers and warehouses), the cost of which is approximately \$1.5 million per store, and for our existing store remodels, in the range of \$220,000 per store remodel, depending on store size. In the event we purchase existing properties, our capital expenditures will depend on the particular property and whether it is improved when purchased. We are continuously reviewing new relationship and funding sources and alternatives for new stores, which may include "sale-leaseback" or direct "purchase-lease" programs, as well as other funding sources for our purchase and construction of those projects. If we are successful in these relationship developments, our direct cash needs should include only our capital expenditures for tenant improvements to leased properties and our remodel programs for existing stores, but could include full ownership if it meets our cash investment strategy.

Net cash from financing activities decreased \$19.6 million from \$11.9 million for the year ended January 31, 2005, to a use of cash of \$7.7 million for the year ended January 31, 2006. This change resulted primarily from increases in payments on various debt instruments of \$10.5 million, as opposed to borrowings in the prior year of \$10.4 million. Partially offsetting the use of cash was increased proceeds from stock issued under employee benefit plans. We do not expect to incur significant net borrowing or repayments under our bank credit facilities in fiscal 2007.

On October 31, 2005, we entered into a new, expanded bank credit facility with the same group of banks that had provided the previous credit arrangement. The new agreement expands the line of credit to \$50 million, from \$35 million, provides an accordion feature to allow further expansion of the facility to \$90 million, under certain conditions, and extends the maturity date to November 1, 2010. Additionally, the facility provides sublimits of \$8 million for a swingline line of credit for faster advances on borrowing requests, and \$5 million for standby letters of credit. Loans under our revolving credit facility may, at our option, bear interest at either the alternate base rate, which is the greater of the administrative agent's prime rate or the federal funds rate, or the adjusted LIBO/LIBOR rate for the applicable interest period, in each case plus an applicable interest margin. The interest margin is between 0.00% and 0.50% for base rate loans and between 0.75% and 1.75% for LIBO/LIBOR alternative rate loans. The interest margin will vary depending on our debt coverage ratio. We additionally pay commitment fees for the undrawn portion of our revolving credit facility. At January 31, 2006 the interest rate on the revolving facility was 7.25%.

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

	Actual	Required Minimum/ Maximum
Debt service coverage ratio must exceed required minimum.....	4.44 to 1.00	2.00 to 1.00
Total adjusted leverage ratio must be lower than required maximum.....	1.53 to 1.00	3.00 to 1.00
Adjusted consolidated net worth must exceed required minimum.....	\$ 237,280,000	\$ 143,240,000
Charge-off ratio must be lower than required maximum.....	0.02 to 1.00	0.06 to 1.00
Extension ratio must be lower than required maximum.....	0.03 to 1.00	0.05 to 1.00
30-day delinquency ratio must be lower than required maximum.....	0.09 to 1.00	0.13 to 1.00

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

Events of default under the credit facility include, subject to grace periods and notice provisions in certain circumstances, non-payment of principal, interest or fees; violation of covenants; material inaccuracy of any representation or warranty; default under or acceleration of certain other indebtedness; bankruptcy and insolvency events; certain judgments and other liabilities; certain environmental claims; and a change of control. If an event of default occurs, the lenders under the credit facility are entitled to take various actions, including accelerating amounts due under the credit facility and requiring that all such amounts be immediately paid in full. Our obligations under the credit facility are secured by all of our and our subsidiaries' assets, excluding customer receivables owned by the QSPE and certain inventory subject to vendor floor plan arrangements.

The following table reflects outstanding commitments for borrowings and letters of credit, and the amounts utilized under those commitments, as of January 31, 2006:

	Commitment Expires in Fiscal Year Ending January 31,						Balance at January 31, 2006	Available at January 31, 2006	
	2007	2008	2009	2010	2011	Thereafter			Total
	(in thousands)								
Revolving Bank Facility (1)....	\$ -			\$ 50,000			\$ 50,000	\$ 3,015	\$ 46,985
Unsecured Line of Credit.....	8,000						8,000	-	8,000
Inventory Financing (2).....	30,000						30,000	12,626	17,374
Letters of Credit.....	1,500						1,500	-	1,500
Total	\$ 39,500	\$ -	\$ -	\$ 50,000	\$ -	\$ -	\$ 89,500	\$ 15,641	\$ 73,859

(1) Includes letter of credit sublimit. There was \$3.0 million of letters of credit issued at January 31, 2006.

(2) Included in accounts payable on the consolidated balance sheet as of January 31, 2006.

Since we extend credit in connection with a large portion of our retail, service maintenance and credit insurance sales, we created a QSPE in 2002 to purchase customer receivables from us and to issue asset-backed and variable funding notes to third parties to finance its purchase of these receivables. We transfer receivables, consisting of retail installment contracts and revolving accounts extended to our customers, to the issuer in exchange for cash, subordinated securities and the right to receive the interest spread between the assets held by the QSPE and the notes issued to third parties and our servicing fees. The subordinated securities issued to us accrue interest based on prime rates and are subordinate to these third party notes.

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 asset-backed securitization program can be adversely affected if we exceed certain predetermined levels of re-aging receivables, write-offs, bankruptcies or other ineligible receivable amounts. If the funding under the asset-backed securitization program were reduced or terminated, we would have to draw down our bank credit facility more quickly than we have estimated.

A summary of the total receivables managed under the credit portfolio, including quantitative information about delinquencies, net credit losses and components of securitized assets, is presented in note 2 to our consolidated financial statements.

Based on current operating plans, we believe that cash provided by operating activities, available borrowings under our credit facility, access to the unfunded portion of the variable funding portion of our asset-backed securitization program and our current cash and cash equivalents will be sufficient to fund our operations, store expansion and updating activities and capital expenditure programs through at least January 31, 2007. However, there are several factors that could decrease cash provided by operating activities, including:

- reduced demand for our products;
- more stringent vendor terms on our inventory purchases;
- loss of ability to acquire inventory on consignment;
- increases in product cost that we may not be able to pass on to our customers;
- reductions in product pricing due to competitor promotional activities;
- changes in inventory requirements based on longer delivery times of the manufacturers or other requirements which would negatively impact our delivery and distribution capabilities;
- increases in the retained portion of our receivables portfolio under our current QSPE's asset-backed securitization program as a result of changes in performance or types of receivables transferred (promotional versus non-promotional);
- 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 programs;
- increases in the program costs (interest and administrative fees relative to our receivables portfolio) associated with the funding of our receivables;
- increases in personnel costs required for us to stay competitive in our markets; and
- our inability to obtain a relationship to provide the purchase of and financing of our capital expenditures for our new stores.

If cash provided by operating activities during this period is less than we expect or if we need additional financing for future growth, we may need to increase our revolving credit facility or undertake additional equity or debt offerings. We may not be able to obtain such financing on favorable terms, if at all.

#### *Off-Balance Sheet Financing Arrangements*

At January 31, 2006, the issuer has issued two series of notes: a Series A variable funding note with a capacity of \$250.0 million purchased by Three Pillars Funding Corporation and three classes of Series B notes in the aggregate amount of \$200.0 million. The commercial paper underlying the Series A variable funding note is rated A1/P1 by Standard and Poors and Moody's, respectively. These ratings represent the highest rating ("highest quality") of each rating agency's three short-term investment grade ratings, except that Standard and Poors could add a "+" which would convert the "highest quality" rating to an "extremely strong" rating. The Series B notes consist of: Class A notes in the amount \$120.0 million, rated Aaa by Moody's representing the highest rating ("highest quality") of the four long term investment grade ratings provided by this organization; Class B notes in the amount \$57.8 million, rated A2 by Moody's representing the middle of the third rating ("upper medium quality") of the four long term investment grade ratings provided by this organization; and Class C notes in the amount of \$22.2 million, rated Baa2/BBB by Moody's and Fitch, respectively. These ratings represent the lowest of the four investment grades ("medium quality") provided by these organizations. The ratings disclosed are not recommendations to buy, sell or hold securities. These ratings may be changed or withdrawn at any time without notice, and each of the ratings should be evaluated independently of any other

rating. We are not aware of a rating by any other rating organization and are not aware of any changes in these ratings. Private institutional investors, primarily insurance companies, purchased the Series B notes. The issuer used the proceeds of these issuances, along with funds provided by us in fiscal 2003 from borrowings under our bank credit facility, to initially purchase eligible accounts receivable from us and to fund a required \$8.0 million restricted cash account for credit enhancement of the Series B notes.

We are entitled to a monthly servicing fee, so long as we act as servicer, in an amount equal to .25% multiplied by the average aggregate principal amount of receivables 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 to either Three Pillars Funding Corporation or the Series B note holders, and the servicing fee. SunTrust Capital Markets, Inc. serves as an administrative agent for Three Pillars Funding Corporation in connection with the Series A variable funding note.

The Series A variable funding note permits the issuer to borrow funds up to \$250.0 million to purchase receivables from us, thereby functioning as a credit facility to accumulate receivables. When borrowings under the Series A variable funding note approach \$250.0 million, the issuer intends to refinance the receivables by issuing a new series of notes and use the proceeds to pay down the outstanding balance of the Series A variable funding note, so that the credit facility will once again become available to accumulate new receivables. As of January 31, 2006, borrowings under the Series A variable funding note were \$185.0 million.

The Series A variable funding note matures on September 1, 2007. The issuer will repay the Series A variable funding note and any refinancing note with amounts received from customers pursuant to receivables that we transferred to the issuer. Beginning on October 20, 2006, the issuer will begin to make scheduled principal payments on the Series B notes with amounts received from customers pursuant to receivables that we transferred to the issuer. To the extent that the issuer has not otherwise repaid the Series B notes, they mature on September 1, 2010. We are currently in negotiations to increase the amount and extend the term of the Series A variable funding note and issue a new series of fixed-rate notes to provide funding for additional purchases of receivables and the paydown of the Series B notes.

The Series A variable funding note bears interest at the commercial paper rate plus an applicable margin, in most instances of 0.8%, and the Series B notes have fixed rates of 4.469%, 5.769% and 8.180% for the Class A, B and C notes, respectively. In addition, there is an annual administrative fee and a non-use fee associated with the unused portion of the committed facility.

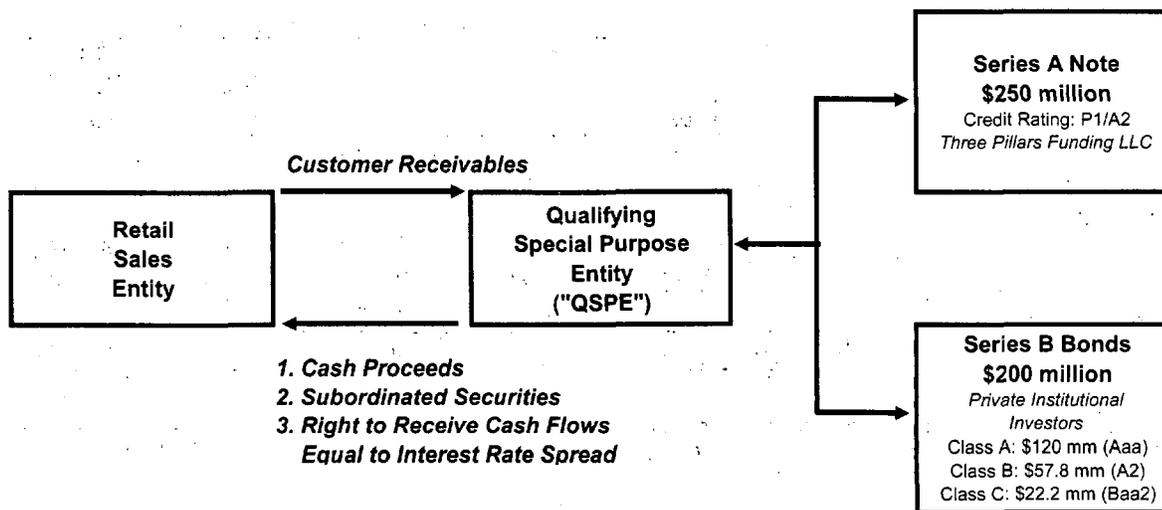
We are not directly liable to the lenders under the asset-backed securitization facility. If the issuer is unable to repay the Series A and Series B notes due to its inability to collect the transferred customer accounts, the issuer could not pay the subordinated notes it has issued to us in partial payment for transferred customer accounts, and the Series B lenders could claim the balance in the restricted cash account. We are also contingently liable under a \$10.0 million letter of credit that secures our performance of our obligations or services under the servicing agreement as it relates to the transferred assets that are part of the asset-backed securitization facility.

The issuer is subject to certain affirmative and negative covenants contained in the transaction documents governing the Series A variable funding note and the Series B notes, including covenants that restrict, subject to specified exceptions: the incurrence of additional 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 covenants 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.

Events of default under the Series A variable funding note and the Series B notes, 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 events pertaining to us. The issuer's obligations under the program are secured by the receivables and proceeds.

## Securitization Facilities

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



### Certain Transactions

Since 1996, we have leased a retail store location of approximately 19,150 square feet in Houston, Texas from Thomas J. Frank, Sr., our Chairman of the Board and Chief Executive Officer. The lease provides for base monthly rental payments of \$17,235 plus escrows for taxes, insurance and common area maintenance expenses of increasing monthly amounts based on expenditures by the management company operating the shopping center of which this store is a part through January 31, 2011. We also have an option to renew the lease for two additional five-year terms. Mr. Frank received total payments under this lease of \$281,000 in fiscal 2004, 2005 and 2006, respectively. Based on market lease rates for comparable retail space in the area, we believe that the terms of this lease are no less favorable to us than we could have obtained in an arms' length transaction at the date of the lease commencement.

We leased six store locations from Specialized Realty Development Services, LP ("SRDS"), a real estate development company that was created prior to our becoming publicly held and was owned by various members of management and individual investors of Stephens Group, Inc., a significant shareholder of the company. Based on independent appraisals that were performed on each project that was completed, we believe that the terms of the leases were at least comparable to those that could be obtained in an arms' length transaction. As part of the ongoing operation of SRDS, we received management fees associated with the administrative functions that were provided to SRDS of \$5,000, \$100,000 and \$6,500 for the years ended January 31, 2004, 2005 and 2006, respectively. As of January 31, 2005, we no longer leased any properties from SRDS since it divested itself of the leased properties. As part of the divestiture, SRDS reimbursed us \$75,000 for costs related to lease modifications.

We engage the services of Direct Marketing Solutions, Inc., or DMS, for a substantial portion of its direct mail advertising. Direct Marketing Solutions, Inc. is partially owned (less than 50%) by the Stephens Group Inc., members of the Stephens family, Jon Jacoby, and Doug Martin. The Stephens Group Inc. and the members of the Stephens family are significant shareholders of the Company, and Jon Jacoby and Doug Martin are members of our Board of Directors. The fees we paid to DMS during fiscal years ended 2005 and 2006 amounted to approximately \$1.8 million and \$4.3 million, respectively. Thomas J. Frank, the Chief Executive Officer and Chairman of the Board of Directors owned a small percentage (0.7%) at the end of fiscal year 2005, but divested his interest during the first half of fiscal year 2006.

## Contractual Obligations

The following table presents a summary of our known contractual obligations as of January 31, 2005, with respect to the specified categories, classified by payments due per period.

	Total	Payments due by period			
		Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Long term debt.....	\$ 136	\$ 136	\$ -	\$ -	\$ -
Operating leases:					
Real estate .....	112,262	14,348	27,448	24,933	45,533
Equipment .....	3,795	1,217	1,439	831	308
Purchase obligations (1) .....	2,789	1,664	1,125	-	-
Total contractual cash obligations .....	<u>\$ 118,982</u>	<u>\$ 17,365</u>	<u>\$ 30,012</u>	<u>\$ 25,764</u>	<u>\$ 45,841</u>

(1) Includes contracts for long-term communication services. Does not include outstanding purchase orders for merchandise, services or supplies which are ordered in the normal course of operations and which generally are received and recorded within 30 days.

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

Interest rates under our bank credit facility 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 LIBO/LIBOR plus the LIBO/LIBOR margin, which ranges from 0.75% to 1.75%. Accordingly, changes in the prime rate, the federal funds rate or LIBO/LIBOR, which are affected by changes in interest rates generally, will affect the interest rate on, and therefore our costs under, our bank credit 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. See footnote 2 to the audited financial statements for disclosures related to the sensitivity of the current fair value of the interest only strip and the subordinated securities to 10% and 20% adverse changes in the factors that affect these assets, including interest rates.

We held interest rate swaps and collars with notional amounts totaling \$20.0 million as of January 31, 2004, with terms extending through April 2005. Those instruments were held for the purpose of hedging variable interest rate risk, primarily related to cash flows from our interest-only strip as well as our variable rate debt. In fiscal 2004, hedge accounting was discontinued for the remaining \$20.0 million. At the time the cash flow hedge designation was discontinued, we began to recognize changes in the fair value of the swaps as interest expense and to amortize the accumulated other comprehensive loss related to those derivatives as interest expense over the period that the forecasted transactions effected the statement of operations. During fiscal 2004, we reclassified \$0.2 million of losses previously recorded in accumulated other comprehensive losses into the statement of operations and recorded \$1.7 million of income into the statement of operations because of the change in fair value of the swaps. During fiscal 2005, we reclassified \$1.1 million of losses previously recorded in accumulated other comprehensive losses into the statement of operations and recorded \$1.1 million of income into the statement of operations because of the change in fair value of the swaps. During fiscal 2006, we reclassified \$0.2 million of losses previously recorded in accumulated other comprehensive losses into the statement of operations and recorded \$0.2 million of income into the statement of operations because of the change in fair value of the swaps.

Prior to discontinuing these hedges, each period we recorded hedge ineffectiveness, which arose from differences between the interest rate stated in the derivative instrument and the interest rate upon which the underlying hedged transaction is based. Ineffectiveness totaled \$0.4 million, for the year ended January 31, 2004, and is reflected in "Interest Expense" in our consolidated statement of operations. Since all hedge accounting has ceased, no ineffectiveness was recognized in fiscal 2005 or 2006.

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

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

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## Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) or Rule 15(d)-15(f) under the Exchange Act. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Our management (with the participation of our principal executive officer and our principal financial officer) assessed the effectiveness of our internal control over financial reporting as of January 31, 2006. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control – Integrated Framework. Based on our assessment and those criteria, management believes that, as of January 31, 2006, our internal control over financial reporting is effective.

Management's assessment of the effectiveness of our internal control over financial reporting as of January 31, 2006 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report which is included elsewhere herein.

Conn's, Inc.  
Beaumont, Texas  
March 30, 2006

/s/ David L. Rogers

David L. Rogers  
*Chief Financial Officer*

/s/ Thomas J. Frank

Thomas J. Frank  
*Chief Executive Officer*

## Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of Conn's, Inc.

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Conn's, Inc. maintained effective internal control over financial reporting as of January 31, 2006, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Conn's, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Conn's, Inc. maintained effective internal control over financial reporting as of January 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Conn's, Inc. maintained, in all material respects, effective internal control over financial reporting as of January 31, 2006, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Conn's, Inc. as of January 31, 2006 and 2005, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended January 31, 2006 of Conn's, Inc. and our report dated March 29, 2006 expressed an unqualified opinion thereon.

Ernst & Young LLP

Houston, Texas  
March 29, 2006

## Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of Conn's, Inc.

We have audited the accompanying consolidated balance sheets of Conn's, Inc. as of January 31, 2006 and 2005, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended January 31, 2006. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Conn's, Inc. at January 31, 2006 and 2005, and the consolidated results of its operations and its cash flows for each of the three years in the period ended January 31, 2006, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, effective January 31, 2004 the Company adopted Financial Standards Board Interpretation No. 46, "Consolidation of Variable Interest Entities".

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of January 31, 2006, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 29, 2006 expressed an unqualified opinion thereon.

Ernst & Young LLP

Houston, Texas  
March 29, 2006

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

Assets	January 31,	
	2005	2006
<b>Current Assets</b>		
Cash and cash equivalents.....	\$ 7,027	\$ 45,176
Accounts receivable, net of allowance for doubtful accounts of \$2,211 and \$914, respectively.....	26,728	23,542
Interest in securitized assets.....	105,159	123,449
Inventories.....	62,346	73,987
Deferred income taxes.....	4,901	4,670
Prepaid expenses and other assets.....	3,552	4,004
<b>Total current assets</b> .....	<b>209,713</b>	<b>274,828</b>
<b>Non-current deferred income tax asset</b> .....	1,523	2,464
<b>Property and equipment</b>		
Land.....	2,919	6,671
Buildings.....	8,068	7,084
Equipment and fixtures.....	10,036	9,612
Transportation equipment.....	4,419	3,284
Leasehold improvements.....	56,926	65,507
Subtotal.....	82,368	92,158
Less accumulated depreciation.....	(34,658)	(37,332)
<b>Total property and equipment, net</b> .....	<b>47,710</b>	<b>54,826</b>
<b>Goodwill, net</b> .....	9,617	9,617
<b>Other assets, net</b> .....	229	260
<b>Total assets</b> .....	<b>\$ 268,792</b>	<b>\$ 341,995</b>
<b>Liabilities and Stockholders' Equity</b>		
<b>Current Liabilities</b>		
Notes payable.....	\$ 5,500	\$ -
Current portion of long-term debt.....	29	136
Accounts payable.....	27,108	40,920
Accrued compensation and related expenses.....	8,548	18,847
Accrued expenses.....	11,928	17,380
Income taxes payable.....	-	8,794
Deferred income taxes.....	966	757
Deferred revenues and allowances.....	7,383	8,498
Fair value of derivatives.....	177	-
<b>Total current liabilities</b> .....	<b>61,639</b>	<b>95,332</b>
<b>Long-term debt</b> .....	5,003	-
<b>Non-current deferred tax liability</b> .....	704	903
<b>Deferred gain on sale of property</b> .....	644	476
<b>Stockholders' equity</b>		
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; 23,267,596 and 23,571,564 shares issued and outstanding at January 31, 2005 and 2006, respectively).....	233	236
Accumulated other comprehensive income.....	7,516	8,004
Additional paid in capital.....	84,257	87,067
Retained earnings.....	108,796	149,977
<b>Total stockholders' equity</b> .....	<b>200,802</b>	<b>245,284</b>
<b>Total liabilities and stockholders' equity</b> .....	<b>\$ 268,792</b>	<b>\$ 341,995</b>

See notes to consolidated financial statements.

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

	Years Ended January 31,		
	2004	2005	2006
<b>Revenues</b>			
Product sales.....	\$402,579	\$451,560	\$569,877
Service maintenance agreement commissions (net).....	20,074	23,950	30,583
Service revenues.....	18,265	18,725	20,278
Total net sales.....	440,918	494,235	620,738
Finance charges and other.....	58,392	72,857	81,684
<b>Total revenues.....</b>	<b>499,310</b>	<b>567,092</b>	<b>702,422</b>
<b>Cost and expenses</b>			
Cost of goods sold, including warehousing and occupancy costs.....	313,637	355,159	448,064
Cost of service parts sold, including warehousing and occupancy cost.....	4,075	4,551	5,310
Selling, general and administrative expense.....	135,174	152,900	181,631
Provision for bad debts.....	4,657	5,637	3,769
<b>Total cost and expenses.....</b>	<b>457,543</b>	<b>518,247</b>	<b>638,774</b>
<b>Operating income.....</b>	<b>41,767</b>	<b>48,845</b>	<b>63,648</b>
Interest expense.....	4,577	2,359	400
<b>Income before minority interest and income taxes.....</b>	<b>37,190</b>	<b>46,486</b>	<b>63,248</b>
Minority interest in limited partnership.....	-	118	-
<b>Income before income taxes.....</b>	<b>37,190</b>	<b>46,368</b>	<b>63,248</b>
<b>Provision for income taxes</b>			
Current.....	12,980	16,147	23,048
Deferred.....	(130)	96	(981)
<b>Total provision for income taxes.....</b>	<b>12,850</b>	<b>16,243</b>	<b>22,067</b>
<b>Net Income.....</b>	<b>24,340</b>	<b>30,125</b>	<b>41,181</b>
Less preferred dividends.....	1,954	-	-
<b>Net income available for common stockholders.....</b>	<b>\$22,386</b>	<b>\$30,125</b>	<b>\$41,181</b>
<b>Earnings per share</b>			
Basic.....	\$1.26	\$1.30	\$1.76
Diluted.....	\$1.22	\$1.27	\$1.70
<b>Average common shares outstanding</b>			
Basic.....	17,726	23,192	23,412
Diluted.....	18,335	23,754	24,192

See notes to consolidated financial statements.

**Conn's, Inc.**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
(in thousands, except per share amounts)

	Preferred Stock		Common Stock		Accum. Other Compre- hensive Income	Paid in Capital	Retained Earnings	Treasury Stock		Total
	Shares	Amount	Shares	Amount				Shares	Amount	
<b>Balance January 31, 2003</b> .....	175	15,226	17,175	\$ 172	\$ 2,751	\$ -	\$ 68,131	\$ 455	\$ (3,611)	\$ 82,669
Preferred dividends declared.....		10,194					(10,194)			
Preferred stock redeemed:										
For cash.....	(10)	(1,454)								(1,454)
For common stock.....	(165)	(23,966)	1,712	17		23,949				-
Additional common stock issued at IPO...			4,623	46		58,311				58,357
Exercise of options.....			47	1		396				397
Cancellation of treasury stock.....			(455)	(5)			(3,606)	(455)	3,611	-
Net income.....							24,340			24,340
Unrealized gain on derivative instruments (net of tax of \$794), net of reclassification adjustments of \$158 (net of tax of \$ 89).....					1,411					1,411
Adjustment of fair value of securitized assets (net of tax of \$489), net of reclassification adjustments of \$ 239 (net of tax of \$ 134).....					870					870
Total comprehensive income.....										26,621
<b>Balance January 31, 2004</b> .....	-	-	23,102	231	5,032	82,656	78,671	-	-	166,590
Exercise of options, including tax benefit.....			162	2		1,492				1,494
Issuance of common stock under Employee Stock Purchase Plan.....			9			109				109
Forfeiture of 5,181 restricted shares.....			(5)							-
Net income.....							30,125			30,125
Reclassification adjustments on derivative instruments (net of tax of \$ 399).....					732					732
Adjustment of fair value of securitized assets (net of tax of \$955), net of reclass- ification adjustments of \$9,643 (net of tax of \$5,249).....					1,752					1,752
Total comprehensive income.....										32,609
<b>Balance January 31, 2005</b> .....	-	-	23,268	233	7,516	84,257	108,796	-	-	200,802
Exercise of options, including tax benefit.....			293	3		2,618				2,621
Issuance of common stock under Employee Stock Purchase Plan.....			11			192				192
Net income.....							41,181			41,181
Reclassification adjustments on derivative instruments (net of tax of \$ 86).....					160					160
Adjustment of fair value of securitized assets (net of tax of \$164), net of reclass- ification adjustments of \$9,175 (net of tax of \$4,963).....					328					328
Total comprehensive income.....										41,669
<b>Balance January 31, 2006</b> .....	-	\$ -	23,572	\$ 236	\$ 8,004	\$87,067	\$149,977	-	\$ -	\$245,284

See notes to consolidated financial statements.

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

	Years Ended January 31,		
	2004	2005	2006
<b>Cash flows from operating activities</b>			
Net income.....	\$ 24,340	\$ 30,125	\$ 41,181
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation.....	6,654	8,777	11,271
Amortization.....	592	18	(318)
Provision for bad debts.....	4,657	5,637	3,769
Accretion from interests in securitized assets.....	(12,529)	(14,892)	(14,138)
Provision for deferred income taxes.....	(130)	96	(981)
Loss (gain) from sale of property and equipment.....	64	126	69
Discounts on promotional credit, net.....	-	1,571	691
Losses (gains) from derivatives.....	(1,010)	(15)	69
Change in operating assets and liabilities:			
Accounts receivable.....	(11,412)	(29,339)	(4,889)
Inventory.....	(7,624)	(8,604)	(11,641)
Prepaid expenses and other assets.....	900	(515)	(452)
Accounts payable.....	1,910	696	13,812
Accrued expenses.....	4,200	7,697	15,751
Income taxes payable.....	2,429	(2,430)	8,794
Deferred revenues and allowances.....	(648)	1,222	1,330
<b>Net cash provided by operating activities.....</b>	<b>12,393</b>	<b>170</b>	<b>64,318</b>
<b>Cash flows from investing activities</b>			
Purchase of property and equipment.....	(9,401)	(19,619)	(18,490)
Proceeds from sales of property.....	1,291	1,131	34
<b>Net cash used in investing activities.....</b>	<b>(8,110)</b>	<b>(18,488)</b>	<b>(18,456)</b>
<b>Cash flows from financing activities</b>			
Net proceeds from the sale of common stock.....	58,357	-	-
Net proceeds from stock issued under employee benefit plans, including tax benefit.....	397	1,603	2,813
Redemption of preferred stock.....	(1,454)	-	-
Net borrowings (payments) under line of credit.....	(31,999)	10,500	(10,500)
Payments on term note.....	(15,000)	-	-
Increase in debt issuance costs.....	(213)	(118)	(130)
Borrowings on promissory notes.....	-	-	136
Payment of promissory notes.....	(4,901)	(60)	(32)
<b>Net cash provided by (used in) financing activities.....</b>	<b>5,187</b>	<b>11,925</b>	<b>(7,713)</b>
<b>Impact on cash of consolidation of SRDS.....</b>	<b>1,024</b>	<b>478</b>	<b>-</b>
<b>Net change in cash.....</b>	<b>10,494</b>	<b>(5,915)</b>	<b>38,149</b>
<b>Cash and cash equivalents</b>			
Beginning of the year.....	2,448	12,942	7,027
End of the year.....	<u>\$ 12,942</u>	<u>\$ 7,027</u>	<u>\$ 45,176</u>
<b>Supplemental disclosure of cash flow information</b>			
Cash interest paid.....	\$ 5,718	\$ 2,387	\$ 635
Cash income taxes paid, net of refunds.....	10,162	19,372	13,179
Cash interest received from interests in securitized assets.....	12,801	19,630	26,996
Cash proceeds from new securitizations.....	213,741	256,139	285,529
Cash flows from servicing fees.....	11,963	14,496	17,542
<b>Supplemental disclosure of non-cash activity</b>			
Customer receivables exchanged for interests in securitized assets.....	41,123	58,342	58,835
Amounts reinvested in interests in securitized assets.....	(56,478)	(81,652)	(76,133)

See notes to consolidated financial statements.

**CONN'S, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

January 31, 2006

**1. Summary of Significant Accounting Policies**

**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. See Note 2 for further discussion.

**Application of FIN 46.** In January 2003, the Financial Accounting Standards Board issued Interpretation No. 46, *Consolidation of Variable Interest Entities, An Interpretation of Accounting Research Bulletin No. 51*, or FIN 46. FIN 46 requires entities, generally, to be consolidated by a company when it has a controlling financial interest through ownership, direct or indirect, of a majority voting interest in an entity with which it conducts business. The Company evaluated the effects of the issuance of FIN 46 on the accounting for its leases with Specialized Realty Development Services, LP ("SRDS") and determined that it was appropriate to consolidate the balance sheet of SRDS with the Company as of January 31, 2004. As of January 31, 2005, the Company no longer leased any of its facilities from SRDS and therefore FIN 46 no longer applies and the Company no longer consolidates SRDS's balance sheet or statement of operations. However, the operations of SRDS are consolidated with those of the Company commencing on February 1, 2004 through the last effective date of the Company's leases with SRDS of January 30, 2005. The effect of such consolidation on the Company's Statement of Operations for the year ended January 31, 2005 was to reduce "Selling, general and administrative expense" by \$0.9 million, increase "Interest expense" by \$0.8 million and reduce "Income before income taxes" by \$0.1 million for "Minority interest in limited partnership". The Company had no exposure to losses incurred by SRDS.

**Business Activities.** The Company, through its retail stores, provides products and services to its customer base in six primary market areas, including southern Louisiana, southeast Texas, Houston, South Texas, San Antonio/Austin, and Dallas, Texas. Products and services offered through retail sales outlets include major home appliances, consumer electronics, home office equipment, lawn and garden products, mattresses, furniture, service maintenance agreements, installment and revolving credit account services, and various credit insurance products. These activities are supported through an extensive service, warehouse and distribution system. For the reasons discussed below, the aggregation of operating companies represent one reportable segment under SFAS No. 131, *Disclosures About Segments of an Enterprise and Related Information*. Accordingly, the accompanying consolidated financial statements reflect the operating results of the Company's single reportable segment. The Company's retail stores bear the "Conn's" name, and deliver the same products and services to a common customer group. The Company's customers generally are individuals rather than commercial accounts. All of the retail stores follow the same procedures and methods in managing their operations. The Company's management evaluates performance and allocates resources based on the operating results of the retail stores and considers the credit programs, service contracts and distribution system to be an integral part of the Company's retail operations.

**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.

**Vendor Programs.** The Company receives funds from vendors for price protection, product and volume rebates, marketing, training and promotional programs which are recorded on as the amounts are earned as a reduction to the related product cost or advertising expense, according to the nature of the program. The Company accrues 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, which would include price protection, product and volume rebates, the allowances, credits, or payments are recorded as a reduction of product cost and are reflected in cost of goods sold when the related product is sold. If the programs relate to marketing, training and promotions that are not for reimbursement of specific incremental costs, the allowances, credits or payments are reflected as a reduction of cost of goods sold. If the programs are related to promotion or marketing of the product, the allowances, credits, or payments for reimbursement of specific, incremental, identifiable, advertising-related costs incurred in selling the vendors' products are recorded as a reduction of advertising expense and are reflected in selling, general and administrative expenses in the period in which the expense is incurred. The credits/payments received from vendors that were netted against advertising expense for the years ended January 31, 2004, 2005 and 2006 were \$2.8 million, \$4.8 million and \$5.8 million, respectively.

**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 (shares in thousands):

	<u>Year Ended January 31,</u>		
	<u>2004</u>	<u>2005</u>	<u>2006</u>
Common stock outstanding, beginning of period .....	17,175	23,102	23,268
Weighted average common stock issued in initial public offering .....	719		-
Weighted average common stock issued in preferred stock redemption .....	285		-
Weighted average common stock issued in stock option exercises .....	2	89	142
Weighted average common stock issued to employee stock purchase plan .....	-	3	2
Weighted average number of restricted shares forfeited .....	-	(2)	
Less: Weighted average treasury shares purchased and weighted average shares purchased and cancelled .....	(455)		-
Shares used in computing basic earnings per share .....	<u>17,726</u>	<u>23,192</u>	<u>23,412</u>
Dilutive effect of stock options, net of assumed repurchase of treasury stock .....	609	562	780
Shares used in computing diluted earnings per share .....	<u><u>18,335</u></u>	<u><u>23,754</u></u>	<u><u>24,192</u></u>

During the periods presented, options with an exercise price in excess of the average market price of the Company's common stock are excluded from the calculation of the dilutive effect of stock options for diluted earnings per share calculations. The weighted average number of options not included in the calculation of the dilutive effect of stock options was 0.1 million for each of the years ended January 31, 2005 and 2006, and none for the year ended January 31, 2004.

**Cash and Cash Equivalents.** The Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

**Inventories.** Inventories consist of finished goods or parts and are valued at the lower of cost (moving weighted average method) or market.

**Property and Equipment.** Property and equipment are recorded at cost. Costs associated with major additions and betterments that increase the value or extend the lives of assets are capitalized and depreciated. Normal repairs and maintenance that do not materially improve or extend the lives of the respective assets are charged to operating expenses as incurred. Depreciation is computed on the straight-line method over the estimated useful lives of the assets, or in the case of leasehold improvements, over the shorter of the estimated useful lives or the remaining terms of the respective leases. The estimated lives used to compute depreciation expense are summarized as follows:

Buildings.....	30 years
Equipment and fixtures .....	3 – 5 years
Transportation equipment.....	3 years
Leasehold improvements.....	5 – 10 years

Property and equipment are evaluated for impairment at the retail store level. The Company performs a periodic assessment of assets for impairment in the absence of such information or indicators. Additionally, an impairment evaluation is performed whenever events or changes in circumstances indicate that the carrying amount of the assets might not be recoverable. The most likely condition that would necessitate an assessment would be an adverse change in historical and estimated future results of a retail store's performance. For property and equipment to be held and used, the Company recognizes an impairment loss if its carrying amount is not recoverable through its undiscounted cash flows and measures the impairment loss based on the difference between the carrying amount and fair value.

All gains and losses on sale of assets are included in "Selling, general and administrative expense" in the consolidated statements of operations.

(in thousands of dollars)	Years Ended January 31,		
	2004	2005	2006
Gain (loss) on sale of assets.....	(64)	(126)	(69)

**Receivable Sales and Interests in Securitized Receivables.** The Company enters into securitization transactions to sell customer retail installment and revolving receivable accounts. In these transactions, the Company retains interest-only strips and subordinated securities, all of which are retained interests in the securitized receivables. Gain or loss on the sales of the receivables depends in part on the previous carrying amount of the financial assets involved in the transfer, allocated between the assets sold and the retained interests, based on their relative fair value at the date of transfer. Retained interests are carried at fair value on the Company's balance sheet as available-for-sale securities in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Impairment and interest income are recognized in accordance with Emerging Issues Task Force ("EITF") No. 99-20, *Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets*. Servicing fees are recognized monthly as they are earned. Gains on sales of receivables, impairment on retained interests, interest income from retained interests and servicing fees are included in "Finance charges and other" in the consolidated statement of operations.

The Company estimates fair value of its retained interest in both the initial securitization and thereafter based on the present value of future expected cash flows using management's best estimates of the key assumptions—credit losses, prepayment rates, forward yield curves, and discount rates commensurate with the risks involved. The Company's retained interest in the transferred receivables are valued on a revolving pool basis.

**Receivables Not Sold.** Certain receivables are not eligible for inclusion in the securitization transactions and are therefore carried on the Company's balance sheet in "Accounts receivable". Such receivables are recorded net of an allowance for doubtful accounts, which is calculated based on historical losses. Generally, a receivable is considered delinquent if a payment has not been received on the scheduled due date. Generally, an account that is delinquent more than 120 days and for which no payment has been received in the past seven months will be charged-off against the allowance and interest accrued subsequent to the last payment will be reversed. The Company has a secured interest in the merchandise

financed by these receivables and therefore has the opportunity to recover a portion of the charged-off value. (See also Note 2.)

**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. In fiscal 2004, 2005 and 2006, the Company concluded that goodwill was not impaired based on its annual impairment testing.

**Income Taxes.** The Company follows the liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the tax rates and laws that are expected to be in effect when the differences are expected to reverse.

**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. The Company sells service maintenance agreements and credit insurance contracts on behalf of unrelated third parties. For contracts where the third parties are the obligor 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. The Company records a receivable for earned but unremitted retrospective commissions and reserves for future cancellations of service maintenance agreements and credit insurance contracts estimated based on historical experience. Where the Company sells service maintenance agreements in which it is 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 Company-obligor service maintenance agreements are renewal contracts which 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 EITF No. 00-21, *Revenue Arrangements with Multiple Deliverables* and are valued based on the agreed upon retail selling price. The amounts of service maintenance agreement revenue deferred at January 31, 2005 and 2006 were \$3.9 million and \$3.6 million, respectively, and are included in "Deferred revenue and allowances" in the accompanying balance sheets. Under the renewal contracts, the Company defers and amortizes its direct selling expenses over the contract term and records the cost of the service work performed as products are repaired.

The classification of the amounts included as "Finance charges and other" is summarized as follows (in thousands):

	<u>Years Ended January 31,</u>		
	<u>2004</u>	<u>2005</u>	<u>2006</u>
Securitization income:			
Servicing fees received.....	\$11,963	\$14,496	\$17,542
Accretion of gains on sale of receivables.....	12,529	14,892	14,138
Interest earned on retained interests.....	12,801	19,630	26,996
Total securitization income.....	37,293	49,018	58,676
Interest Income from receivables not sold.....	888	1,224	1,181
Insurance commissions.....	16,498	17,992	18,305
Other.....	3,713	4,623	3,522
Finance charges and other.....	<u>\$58,392</u>	<u>\$72,857</u>	<u>\$81,684</u>
 Gains on sale of receivables.....	 <u>\$13,510</u>	 <u>\$17,604</u>	 <u>\$14,692</u>

Securitization income includes accretion of gains on sales of receivables, impairment of retained interests, interest income from retained interests and servicing fees. No significant impairments related to the interest only strip of retained interests have been recorded in the years ended January 31, 2004, 2005, or 2006. Gains on sale of receivables will be recognized as securitization income as accretion over the lives of the related receivables. See "Receivable Sales and Interest in Securitized Receivables" for revenue recognition policies related to these components.

The Company offers interest free promotional programs for three- to 24-month contracts and has recorded interest income only on those contracts that are not expected to make payments within the time period specified to satisfy the promotional requirements. The Company also offers 24- and 36-month no-interest contracts on which no interest is owed for the term of the contract, unless the terms of the contract related to periodic payments are not met, in which case interest accrues at the normal contract rate from that point forward. Other than these promotional programs, the Company does not extend credit at interest rates other than market rates.

The following table sets forth the sales made under the interest free programs (in thousands):

	<u>Years Ended January 31,</u>		
	<u>2004</u>	<u>2005</u>	<u>2006</u>
Sales under interest-free programs .....	\$66,986	\$126,575	\$159,767

These sales are recognized at the time the product is delivered to the customer, which is consistent with the above stated policy. Considering the short-term nature of interest free programs for terms less than one year, sales are recorded at full value and are not discounted. Sales financed by longer-term (18-, 24- and 36-month) interest free programs are recorded at their net present value (see "Application of APB 21 to Cash Option Programs that Exceed One Year in Duration" below). Receivables arising out of the Company's interest-free programs are securitized with other qualifying customer receivables.

The Company classifies amounts billed to customers relating to shipping and handling as revenues. Costs of \$15.1 million, \$16.7 million and \$21.0 million associated with shipping and handling revenues are included in "Selling, general and administrative expense" for the years ended January 31, 2004, 2005 and 2006, respectively.

**Fair Value of Financial Instruments.** The fair value of cash and cash equivalents, receivables, and notes and accounts payable approximate their carrying amounts because of the short maturity of these instruments. The fair value of the Company's interests in securitized receivables is determined by estimating the present value of future expected cash flows using management's best estimates of the key assumptions, including credit losses, prepayment rates, forward yield curves and discount rates commensurate with the risks involved. See Note 2. The carrying value of the Company's long-term debt approximates fair value due to either the time to maturity or the existence of variable interest rates that approximate current market rate.

The fair value of interest rate swap agreements are recorded in current liabilities based on the settlement value obtained from the counter-party in the transaction. The Company does not use derivative financial instruments for trading purposes. The Company uses derivatives to hedge a portion of the variable interest rate risk related to the cash flows from its interest only strip and its variable rate debt.

We held interest rate swaps and collars with notional amounts totaling \$20 million at both January 31, 2004 and 2005, with terms extending through April 2005. Those instruments were held for the purpose of hedging a portion of the variable interest rate risk, primarily related to cash flows from our interest-only strip as well as our variable rate debt. Hedge accounting was discontinued for the rate swaps in fiscal 2004. At the time the cash flow hedge designation was discontinued, we began to recognize changes in the fair value of the swaps as interest expense and amortize the accumulated other comprehensive loss related to those derivatives as interest expense over the period that the forecasted transactions effected the statement of operations. During fiscal 2004, we reclassified \$0.2 million of losses previously recorded in accumulated other comprehensive losses into the statement of operations and recorded \$1.7 million of income into the statement of operations because of the change in fair value of the swaps. During fiscal 2005, we reclassified \$1.1 million of losses previously recorded in accumulated other comprehensive losses into the statement of operations and recorded \$1.1 million of income into the statement of operations because of the change in

fair value of the swaps. During fiscal 2006, we reclassified \$0.2 million of losses previously recorded in accumulated other comprehensive losses into the statement of operations and recorded \$0.2 million of income into the statement of operations because of the change in fair value of the swaps.

Prior to discontinuing these hedges, each period we recorded hedge ineffectiveness, which arose from differences between the interest rate stated in the derivative instrument and the interest rate upon which the underlying hedged transaction is based. Ineffectiveness totaled \$0.4 million for the year ended January 31, 2004, and is reflected in "Interest Expense" in our consolidated statement of operations. Since all hedge accounting has ceased, no ineffectiveness was recognized in fiscal 2005 or 2006.

**Stock-Based Compensation.** As permitted by SFAS No. 123, *Accounting for Stock-Based Compensation*, the Company follows the intrinsic value method of accounting for stock-based compensation issued to employees, as prescribed by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. Since all options have been issued at or above fair value, no compensation expense has been recognized under the Company's stock option plan for any of the periods presented. Additionally, no compensation expense is recorded for shares issued pursuant to the employee stock purchase plan as it is a qualified plan.

If compensation expense for the Company's stock option plan and employee stock purchase plan had been recognized using the fair value method of accounting under SFAS 123, net income and earnings per share would have decreased by the percentages reflected in the tables below. The straight-line attribution method was used to allocate compensation expense over the vesting period for the stock option plan. The fair value of the options issued was estimated on the date of grant, with the weighted average assumptions used for grants as reflected in the table. For post-IPO grants the Company has used the Black-Scholes model to determine fair value. Prior to the IPO, the fair value of the options issued was estimated using the minimum valuation option-pricing model. Fair value compensation expense for the employee stock purchase plan was computed as the 15% discount from fair market value the employee receives when purchasing the shares. The following presents the impact to earnings per share if the Company had adopted the fair value recognition provisions of SFAS 123 (dollars in thousands except per share data):

	<b>Years Ended January 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
Net income available for common stockholders as reported.....	\$ 22,386	\$ 30,125	\$ 41,181
Stock-based compensation, net of tax, that would have been reported under SFAS 123 .....	(530)	(1,017)	(1,313)
Pro forma net income .....	<u>\$ 21,856</u>	<u>\$ 29,108</u>	<u>\$ 39,868</u>
<b>Earnings per share-as reported:</b>			
Basic .....	\$ 1.26	\$ 1.30	\$ 1.76
Diluted .....	\$ 1.22	\$ 1.27	\$ 1.70
<b>Pro forma earnings per share:</b>			
Basic .....	\$ 1.23	\$ 1.26	\$ 1.70
Diluted .....	\$ 1.20	\$ 1.23	\$ 1.66
<b>Percent change:</b>			
Net income .....	(2.4)%	(3.4)%	(3.2)%
<b>Assumptions used in pricing model:</b>			
Weighted average risk free interest rates.....	0.9 %	1.8 %	3.9 %
Weighted average expected lives in years.....	4.3	4.4	4.6
Weighted average volatility.....	37.5 %	30.0 %	32.0 %
Expected dividends.....	-	-	-

**Self insurance.** The Company is self-insured for certain losses relating to group health, workers' compensation, automobile, general and product liability claims. The Company has stop loss coverage to limit the exposure arising from these claims. Self-insurance losses for claims filed and claims incurred, but not reported, are accrued based upon the Company's estimates of the aggregate liability for uninsured claims incurred using development factors based on historical experience.

**Expense Classifications.** The Company records "Cost of goods sold" as the direct cost of products sold, any related in-bound freight costs, and receiving costs, inspection costs, internal transfer costs, and other costs associated with the operations of its distribution system. Also included in "Cost of goods sold" is an allocation of advertising expense computed at approximately 6% of the product direct cost. The offset for this allocation is in "Selling, general and administrative expense" and is netted with advertising costs along with vendor rebates (see "Vendor Programs" above). Advertising expense included in Selling, general and administrative expense for the years ended January 31, 2004, 2005 and 2006, was:

	<u>Years Ended January 31,</u>		
	<u>2004</u>	<u>2005</u>	<u>2006</u>
	(in thousands)		
Gross advertising expense .....	\$ 24,686	\$ 28,564	\$ 32,107
Less:			
Vendor rebates .....	(2,812)	(4,752)	(5,793)
Allocation to Cost of goods sold .....	<u>(17,517)</u>	<u>(20,635)</u>	<u>(26,621)</u>
Net advertising expense in			
Selling, general and administrative expense .....	<u>\$ 4,357</u>	<u>\$ 3,177</u>	<u>\$ (307)</u>

In addition, the Company records as "Cost of service parts sold" the direct cost of parts used in its service operation and the related inbound freight costs, purchasing and receiving costs, inspection costs, internal transfer costs, and other costs associated with the warranty and service distribution operation.

The costs associated with the Company's merchandising function, including product purchasing, advertising, sales commissions, and all store occupancy costs are included in "Selling, general and administrative expense."

**Application of APB 21 to Cash Option Programs that Exceed One Year in Duration.** In February 2004, the Company began offering 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 years ended January 31, 2005 and 2006, "Product sales" were reduced by \$2.4 million and \$3.1 million, respectively, and "Finance charges and other" was increased by \$0.9 million and \$2.4 million, respectively, to effect the adjustment to fair value and to reflect the appropriate amortization of the discount.

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

**Accumulated Other Comprehensive Income.** The balance of accumulated other comprehensive income (net of tax) at January 31, 2005 was comprised of \$7.7 million of unrealized gains on interests in securitized assets less \$0.2 million of unrealized losses on derivatives. The balance of accumulated other comprehensive income (net of tax) at January 31, 2006 was comprised of \$8.0 million of unrealized gains on interests in securitized assets.

**Recent Accounting Pronouncements.** In December 2004, SFAS No. 123R, *Share-Based Payment*, was issued. The statement is a revision of SFAS No. 123 and supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*. This statement establishes standards for accounting for transactions in which an entity exchanges its equity instruments for goods or services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments. The statement focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions, and does not change the previous accounting guidance for share-based payment transactions with parties other than employees. This 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. Additionally, employee services received in exchange for liability awards will be measured at fair value and re-measured at each reporting date, with changes in the fair value recorded as compensation cost over that period.

This statement applies to all awards granted after the required effective date and to awards modified, repurchased or cancelled after that date. The cumulative effect of initially applying this statement, if any, is recognized as of the required effective date. As of the required effective date, all public entities will apply this statement using a modified version of prospective application, which requires recognition of compensation cost on or after the required effective date for the portion of outstanding awards for which the requisite service has not yet been rendered. For periods before the required effective date, entities may elect to apply a modified version of retrospective application under which financial statements for prior periods are adjusted on a basis consistent with the pro forma disclosures required for those periods by SFAS No. 123. The Company is required to adopt this statement on February 1, 2006, and intends to elect the modified retrospective application and will adjust the financial statements for prior periods to give effect to the fair-value-based method of accounting for share-based payments. See Note 1 – Stock-Based Compensation for the expected impact on prior year "Net income".

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

In March 2006, SFAS No. 156, *Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140*, was issued. This statement requires an entity to recognize a servicing asset or liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract, requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, permits an entity to choose either the amortization method or fair value measurement method for subsequent measurement of each class of separately recognized servicing assets, permits, at its initial adoption, a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights and, requires separate presentation of and additional disclosures for servicing assets and servicing liabilities subsequently measured at fair value. This statement is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Company is currently analyzing the impact this statement will have on its consolidated results of operations and its financial position.

## 2. Interests in Securitized Receivables

The Company has an agreement to sell customer receivables. As part of this agreement, the Company sells eligible retail installment and revolving receivable accounts to a QSPE that pledges the transferred accounts to a trustee for the benefit of investors. The following table summarizes the availability of funding under the Company's securitization program at January 31, 2006 (in thousands):

	<u>Capacity</u>	<u>Utilized</u>	<u>Available</u>
Series A .....	\$250,000	\$185,000	\$65,000
Series B – Class A .....	120,000	120,000	—
Series B – Class B .....	57,778	57,778	—
Series B – Class C .....	22,222	22,222	—
Total .....	<u>\$450,000</u>	<u>\$385,000</u>	<u>\$65,000</u>

The Series A program functions as a credit facility to fund the initial transfer of eligible receivables. When the facility approaches capacity, the QSPE ("Issuer") intends to seek financing to pay down the outstanding balance in the Series A variable funding note; at that point, the facility will once again become available to accumulate the transfer of new receivables or to meet required principal payments on other series as they become due. This new financing could be in the form of additional notes, bonds or other instruments as the market might allow. The Series A program matures September 1, 2007. The Series B program (which is non-amortizing for the first four years) matures officially on September 1, 2010, although it is expected that the principal payments, which are required to begin in October 2006, will retire the bonds prior to that date.

The agreement contains certain covenants requiring the maintenance of various financial ratios and receivables performance standards. The Company was in compliance with the requirements of the agreement as of January 31, 2006. As part of the new securitization program, the Company and Issuer arranged for the issuance of a stand-by letter of credit in the amount of \$10.0 million to provide assurance to the trustee on behalf of the bondholders that funds collected monthly by the Company, as servicer, will be remitted as required under the base indenture and other related documents. The letter of credit has a term of one year, and the maximum potential amount of future payments is the face amount of the letter of credit. The letter of credit is callable, at the option of trustee, if the Company, as servicer, fails to make the required monthly payments of the cash collected to the trustee.

Through its retail sales activities, the Company generates customer retail installment and revolving receivable accounts. The Company enters into securitization transactions to sell these accounts to the QSPE. In these securitizations, the Company retains servicing responsibilities and subordinated interests. The Company receives annual servicing fees and other benefits approximating 3.9% of the outstanding balance and rights to future cash flows arising after the investors in the securities issued by or on behalf of the QSPE have received from the trustee all contractually required principal and interest amounts. The Company does not record an asset or liability related to any servicing obligations because the servicing benefits received are determined to be just adequate to compensate the Company for its servicing responsibilities. The investors and the securitization trustee have no recourse to the Company's other assets for failure of the individual customers of the Company and the QSPE to pay when due. The Company's retained interests are subordinate to the investors' interests. Their value is subject to credit, prepayment, and interest rate risks on the transferred financial assets.

The fair values of the Company's interest in securitized assets were as follows (in thousands):

	January 31,	
	2005	2006
Interest-only strip .....	\$ 16,365	\$ 18,853
Subordinated securities .....	88,794	104,596
Total fair value of interests in securitized assets .....	<u>\$ 105,159</u>	<u>\$ 123,449</u>

The table below summarizes valuation assumptions used for each period presented:

	Years Ended January 31,		
	2004	2005	2006
<b>Prepayment rates</b>			
Primary installment.....	1.5%	1.5%	1.5%
Primary revolving.....	3.0%	3.0%	3.0%
Secondary installment.....	1.5%	1.5%	1.5%
<b>Net interest spread</b>			
Primary installment.....	12.2%	12.0%	11.1%
Primary revolving.....	12.2%	12.0%	11.1%
Secondary installment.....	13.0%	13.6%	13.5%
<b>Expected losses</b>			
Primary installment.....	3.5%	3.4%	3.0%
Primary revolving.....	3.5%	3.4%	3.0%
Secondary installment.....	3.5%	3.4%	3.0%
<b>Projected expense</b>			
Primary installment.....	3.9%	3.9%	3.9%
Primary revolving.....	3.9%	3.9%	3.9%
Secondary installment.....	3.9%	3.8%	3.9%
<b>Discount rates</b>			
Primary installment.....	10.0%	10.0%	13.0%
Primary revolving.....	10.0%	10.0%	13.0%
Secondary installment.....	14.0%	14.0%	17.0%
<b>Delinquency and deferral rates</b>			
Primary installment.....	9.4%	10.1%	9.3%
Primary revolving.....	11.3%	8.9%	7.3%
Secondary installment.....	16.5%	15.3%	14.0%

At January 31, 2006, key economic assumptions and the sensitivity of the current fair value of the interests in securitized assets to immediate 10% and 20% adverse changes in those assumptions are as follows (dollars in thousands):

	<b>Primary Portfolio Installment</b>	<b>Primary Portfolio Revolving</b>	<b>Secondary Portfolio Installment</b>
<b>Fair value of interest in securitized assets</b> .....	\$87,491	\$ 9,691	\$26,267
<b>Expected weighted average life</b> .....	1.2 years	1.4 years	1.6 years
<b>Annual prepayment rate assumption</b> .....	1.5 %	3.0 %	1.5 %
Impact on fair value of 10% adverse change.....	\$ 122	\$ 14	\$ 108
Impact on fair value of 20% adverse change.....	\$ 240	\$ 27	\$ 210
<b>Net interest spread assumption</b> .....	11.1 %	11.1 %	13.5 %
Impact on fair value of 10% adverse change.....	\$ 2,845	\$ 315	\$ 1,545
Impact on fair value of 20% adverse change.....	\$ 5,630	\$ 624	\$ 3,019
<b>Expected losses assumptions</b> .....	3.0 %	3.0 %	3.0 %
Impact on fair value of 10% adverse change.....	\$ 775	\$ 86	\$ 349
Impact on fair value of 20% adverse change.....	\$ 1,546	\$ 171	\$ 695
<b>Projected expense assumption</b> .....	3.9 %	3.9 %	3.9 %
Impact on fair value of 10% adverse change.....	\$ 983	\$ 109	\$ 421
Impact on fair value of 20% adverse change.....	\$ 1,966	\$ 217	\$ 841
<b>Discount rate assumption</b> .....	13.0 %	13.0 %	17.0 %
Impact on fair value of 10% adverse change.....	\$ 821	\$ 91	\$ 482
Impact on fair value of 20% adverse change.....	\$ 1,630	\$ 181	\$ 951
<b>Delinquency and deferral</b> .....	9.3 %	7.3 %	14.0 %
Impact on fair value of 10% adverse change (1).....	\$ 73	\$ 8	\$ 96
Impact on fair value of 20% adverse change (1).....	\$ 146	\$ 16	\$ 186

(1) For purposes of this analysis, an adverse change is assumed to be a decrease in the delinquency and deferral rate. A decrease results in a faster repayment of the loans, which reduces the fair value of the interest-only strip a greater amount than the resulting increase in the fair value of the subordinated securities. Since it is assumed that none of the other assumptions would change, an increase in the delinquency and deferral rate results in an increase in the fair value, (i.e. losses are not assumed to increase as a result).

These sensitivities are hypothetical and should be used with caution. As the figures indicate, changes in fair value based on a 10% variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also, the effect of the variation in a particular assumption on the fair value of the interest-only strip is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another (i.e. increases in market interest rates may result in lower prepayments and increased credit losses), which might magnify or counteract the sensitivities.

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

	Total Principal Amount of Receivables		Principal Amount Over 60 Days Past Due (1)	
	January 31,		January 31,	
	2005	2006	2005	2006
Primary portfolio:				
Installment.....	\$328,042	\$380,603	\$ 16,636	\$ 24,934
Revolving.....	30,210	41,046	867	1,095
Subtotal.....	358,252	421,649	17,503	26,029
Secondary portfolio:				
Installment.....	70,448	98,072	5,640	9,508
Total receivables managed.....	428,700	519,721	23,143	35,537
Less receivables sold.....	419,172	509,681	21,540	33,483
Receivables not sold.....	9,528	10,040	\$ 1,603	\$ 2,054
Non-customer receivables.....	17,200	13,502		
Total accounts receivable, net.....	\$ 26,728	\$ 23,542		

	Average Balances		Net Credit Losses	
	January 31, (1)		January 31, (2)	
	2005	2006	2005	2006
Primary portfolio:				
Installment.....	\$297,187	\$352,315		
Revolving.....	25,921	35,149		
Subtotal.....	323,108	387,464	\$ 8,829	\$ 11,303
Secondary portfolio:				
Installment.....	64,484	83,461	2,394	2,421
Total receivables managed.....	387,592	470,925	11,223	13,724
Less receivables sold.....	378,178	461,215	9,760	13,165
Receivables not sold.....	\$ 9,414	\$ 9,710	\$ 1,463	\$ 559

(1) Amounts are based on end of period balances.

(2) Amounts represent total loan loss provision, net of recoveries, on total receivables.

### 3. Notes Payable and Long-Term Debt

At January 31, 2006, the Company had \$47.0 million of its \$50 million revolving credit facility available for borrowings. The amounts utilized under the revolving credit facility reflected \$3.0 million related to letters of credit issued. The letters of credit were issued under a \$5.0 million sublimit provided under the facility for standby letters of credit. Additionally, there were no amounts outstanding under a short-term revolving bank agreement that provides up to \$8.0 million of availability on an unsecured basis. This unsecured facility matures in May 2006 and has a floating rate of interest, based on Prime, which equaled 7.00% at January 31, 2006.

Long-term debt consists of the following (in thousands, except repayment explanations):

	January 31,	
	2005	2006
Revolving credit facility with interest at variable rates (7.25% at January 31, 2006).....	\$ 5,000	\$ -
Promissory notes, due in monthly installments.....	32	136
Total long-term debt.....	5,032	136
Less amounts due within one year.....	(29)	(136)
Amounts classified as long-term.....	<u>\$ 5,003</u>	<u>\$ -</u>

The revolving facility is subject to the Company maintaining various financial and non-financial covenants. In addition, the provisions of the bank credit facility limit the payment of dividends on the Company's common stock. As of January 31, 2005 and January 31, 2006, the Company was in compliance with all financial and non-financial covenants.

The current agreement provides for a revolving facility capacity of \$50 million, with a \$5 million letter of credit sublimit and an \$8.0 million sublimit for a swingline of credit. Interest rates are variable and are determined, at the option of the Company, at the Base Rate (the greater of Agent's prime rate or federal funds rate plus 0.50%) plus the Base Rate Margin (which ranges from 0.00% to 0.50%) or LIBO/LIBOR Rate plus the LIBO/LIBOR Margin (which ranges from 0.75% to 1.75%). Both the Base Rate Margin and the LIBO/LIBOR Margin are determined quarterly based on a debt coverage ratio equal to the rolling four-quarter relationship of total debt (including lease obligations) to earnings before interest, taxes, depreciation, amortization and rent. The Company is obligated to pay a non-use fee on a quarterly basis on the non-utilized portion of the revolving facility at rates ranging from .20% to .375%. The revolving facility is secured by the assets of the Company not otherwise encumbered and a pledge of substantially all of the stock of the Company's present and future subsidiaries and matures in November 2010.

Interest expense incurred on notes payable and long-term debt totaled \$2.2, \$1.1 and \$0.2 million for the years ended January 31, 2004, 2005 and 2006, respectively. Interest expense included interest related to SRDS debt, which totaled \$0.8 million for the year ended January 31, 2005. Aggregate maturities of long-term debt as of January 31 in the year indicated are as follows (in thousands):

2007.....	\$ 136
2008.....	-
2009.....	-
Total.....	<u>\$ 136</u>

#### 4. Letters of Credit

The Company utilizes unsecured letters of credit to secure a portion of the QSPE's asset-backed securitization program, deductibles under the Company's insurance programs and international product purchases. At January 31, 2005 and January 31, 2006, the Company had outstanding unsecured letters of credit of \$12.1 million and \$13.0 million, respectively. These letters of credit were issued under the three following facilities:

- The Company has a \$5.0 million sublimit provided under its revolving line of credit for stand-by and import letters of credit. At January 31, 2006, \$3.0 million of letters of credit were outstanding and callable at the option of the Company's insurance carrier if the Company does not honor its requirement to fund deductible amounts as billed under its insurance program.
- 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 obtained a \$1.5 million commitment for trade letters of credit to secure product purchases under an international arrangement. At January 31, 2006, there were no letters of credit

outstanding under this commitment. The letter of credit commitment has a term of one year and expires in May 2006.

The maximum potential amount of future payments under these letter of credit facilities is considered to be the aggregate face amount of each letter of credit commitment, which total \$16.5 million as of January 31, 2006.

## 5. Income Taxes

Deferred income taxes reflect the net effects of temporary timing differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's net deferred tax assets result primarily from differences between financial and tax methods of accounting for income recognition on service contracts and residual interests, capitalization of costs in inventory, and deductions for depreciation and doubtful accounts, and the fair value of derivatives. The deferred tax assets and liabilities are summarized as follows (in thousands):

	<b>January 31,</b>	
	<b>2005</b>	<b>2006</b>
<b>Deferred Tax Assets</b>		
Allowance for doubtful accounts and warranty and insurance cancellations .....	\$ 763	\$ 1,844
Deferred revenue .....	2,204	597
Fair value of derivatives .....	62	-
Interest in securitized assets .....	479	982
Property and equipment .....	1,297	2,297
Inventories .....	952	772
Accrued vacation and other .....	667	1,268
Total deferred tax assets .....	<u>6,424</u>	<u>7,760</u>
<b>Deferred Tax Liabilities</b>		
Sales tax receivable .....	(919)	(768)
Goodwill .....	(672)	(903)
Other .....	(79)	(615)
Total deferred tax liabilities .....	<u>(1,670)</u>	<u>(2,286)</u>
<b>Net Deferred Tax Asset</b> .....	<u>\$ 4,754</u>	<u>\$ 5,474</u>

Significant components of income taxes were as follows (in thousands):

	<b>Years Ended January 31,</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
<b>Current:</b>			
Federal .....	\$ 13,095	\$ 16,100	\$ 23,023
State .....	(115)	47	25
Total current .....	<u>12,980</u>	<u>16,147</u>	<u>23,048</u>
<b>Deferred:</b>			
Federal .....	(339)	96	(975)
State .....	209	-	(6)
Total deferred .....	<u>(130)</u>	<u>96</u>	<u>(981)</u>
Total tax provision .....	<u>\$ 12,850</u>	<u>\$ 16,243</u>	<u>\$ 22,067</u>

A reconciliation of the statutory tax rate and the effective tax rate for each of the periods presented in the statements of operations is as follows:

	Years Ended January 31,		
	2004	2005	2006
U.S. Federal statutory rate.....	35.0 %	35.0 %	35.0 %
State and local income taxes.....	0.3	0.1	0.1
Non-deductible entertainment, tax-free interest income and other .....	0.2	0.4	(0.1)
Effective tax rate attributable to continuing operations...	35.5 %	35.5 %	35.0 %
Other.....	(0.9)	(0.5)	(0.1)
Effective tax rate.....	<u>34.6 %</u>	<u>35.0 %</u>	<u>34.9 %</u>

## 6. Leases

The Company leases certain of its facilities and operating equipment from outside parties and from a stockholder/officer. The real estate leases generally have initial lease periods of from 5 to 15 years with renewal options at the discretion of the Company; the equipment leases generally provide for initial lease terms of three to seven years and provide for a purchase right by the Company at the end of the lease term at the fair market value of the equipment.

The following is a schedule of future minimum base rental payments required under the operating leases that have initial non-cancelable lease terms in excess of one year (in thousands):

Years Ended January 31,	Third Party	Related Party	Total
2007.....	\$ 15,358	\$ 207	\$ 15,565
2008.....	14,764	207	14,971
2009.....	13,709	207	13,916
2010.....	13,077	207	13,284
2011.....	12,273	207	12,480
Thereafter.....	45,841	-	45,841
Total.....	<u>\$ 115,022</u>	<u>\$ 1,035</u>	<u>\$ 116,057</u>

Total lease expense was approximately \$14.0 million, \$15.0 million and \$15.7 million for the years ended January 31, 2004, 2005 and 2006, respectively, including approximately \$1.6 million, \$0.2 million and \$0.2 million paid to related parties, respectively. During the year ended January 31, 2005, the Company paid \$1.4 million under leases with SRDS. As SRDS was consolidated in the statement of operations for the year ended January 31, 2005, these payments were characterized as selling, general and administrative expenses, depreciation expense, interest expense and minority interest in limited partnership. See Note 1.

Certain of our leases are subject to scheduled minimum rent increases or escalation provisions, the cost of which is recognized on a straight-line basis over the minimum lease term. Tenant improvement allowances, when granted by lessor, are deferred and amortized as contra-lease expense over the term of the lease.

## 7. Stock-Based Compensation

The Company approved an Incentive Stock Option Plan that provides for a pool of up to 3.5 million options to purchase shares of the Company's common stock. Such options are to be granted to various officers and employees at prices equal to the market value on the date of the grant. The options vest over three or five year periods (depending on the grant) and expire ten years after the date of grant. As part of the completion of the IPO, the Company amended the Incentive Stock Option Plan to provide for a total available pool of 2,559,767 options, adopted a Non-Employee Director Stock Option Plan that included 300,000 options, and adopted an Employee Stock Purchase Plan that reserved up to 1,267,085 shares of the Company's common stock to be issued. On November 24, 2003, the Company issued six non-employee directors 240,000 total options to acquire the Company's stock at \$14.00 per share. On June 3, 2004, the

Company issued 40,000 options to acquire the Company's stock at \$17.34 per share to a seventh non-employee director. At January 31, 2006, the Company had 20,000 options remaining in the Non-Employee Director Stock Option Plan.

The Employee Stock Purchase Plan is available to a majority of the employees of the Company and its subsidiaries, subject to minimum employment conditions and maximum compensation limitations. At the end of each calendar quarter, employee contributions are used to acquire shares of common stock at 85% of the lower of the fair market value of the common stock on the first or last day of the calendar quarter. During the year ended January 31, 2005 and 2006, the Company issued 8,664 and 10,496 shares of common stock, respectively, to employees participating in the plan, leaving 1,247,925 shares remaining reserved for future issuance under the plan as of January 31, 2006.

A summary of the status of the Company's Incentive Stock Option Plan and the activity during the years ended January 31, 2004, 2005 and 2006 is presented below (shares in thousands):

	Years Ended January 31,					
	2004		2005		2006	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of year.....	1,241	\$ 8.34	1,531	\$ 9.68	1,666	\$ 11.50
Granted.....	369	14.00	387	17.43	343	33.88
Exercised.....	(47)	(8.36)	(162)	(8.72)	(271)	(8.34)
Canceled.....	(32)	(9.15)	(90)	(11.07)	(112)	(17.78)
Outstanding, end of year.....	<u>1,531</u>	<u>\$ 9.68</u>	<u>1,666</u>	<u>\$ 11.50</u>	<u>1,626</u>	<u>\$ 16.31</u>
Weighted average grant date fair value of options granted during period:.....		<u>\$ 4.77</u>		<u>\$ 4.97</u>		<u>\$ 11.09</u>
Options exercisable at end of year.....	551		712		743	
Options available for grant.....	981		684		453	

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Shares Outstanding January 31, 2006	Weighted Average Remaining Contractual Life in Years	Weighted Average Exercise Price	Shares Exercisable January 31, 2006	Weighted Average Exercise Price
\$4.29-\$4.29.....	9	3.9	\$ 4.29	9	\$ 4.29
\$8.21-\$10.83.....	696	5.3	8.51	569	8.38
\$14.00-\$16.49.....	306	7.9	14.33	108	14.17
\$17.73-\$17.73.....	288	8.9	17.73	57	17.73
\$33.88-\$33.88.....	327	9.8	33.88	-	-
Total.....	<u>1,626</u>	<u>7.3</u>	<u>\$ 16.31</u>	<u>743</u>	<u>\$ 9.88</u>

## 8. Significant Vendors

As shown in the table below, a significant portion of the Company's merchandise purchases for years ended January 31, 2004, 2005 and 2006 were made from six vendors:

Vendor	Years Ended January 31,		
	2004	2005	2006
A.....	15.5 %	14.2 %	17.0 %
B.....	11.2	13.8	12.2
C.....	12.5	13.2	11.4
D.....	5.7	8.0	7.8
E.....	4.0	6.7	6.8
F.....	4.7	5.8	5.4
Totals.....	<u>53.6 %</u>	<u>61.7 %</u>	<u>60.6 %</u>

As part of a program to purchase product inventory from vendors overseas, the Company was not obligated at January 31, 2006 for under any stand-by letters of credit.

## 9. Related Party Transactions

The Company leases one of its stores from its Chief Executive Officer and Chairman of Board, under the terms of a lease it entered prior to becoming a publicly held company. It also leased six store locations from Specialized Realty Development Services, LP ("SRDS"), a real estate development company that was created prior to the Company's becoming publicly held and was owned by various members of management and individual investors of Stephens Group, Inc. The Stephens Group, Inc. is a significant shareholder of the Company. Based on independent appraisals that were performed on each project that was completed, the Company believes that the terms of the leases were at least comparable to those that could be obtained in an arms' length transaction. As part of the ongoing operation of SRDS, the Company received a management fee associated with the administrative functions that were provided to SRDS of \$5,000, \$100,000 and \$6,500 for the years ended January 31, 2004, 2005 and 2006, respectively. As of January 31, 2005, the Company no longer leased any properties from SRDS since it divested itself of the leased properties. As part of the divestiture, SRDS reimbursed the Company \$75,000 for costs related to lease modifications. As a result of the divestiture, the Company's consolidated balance sheet at January 31, 2005 does not include accounts of SRDS that were previously consolidated with our financial statements at January 31, 2004. However, the consolidated statements of operations and cash flows for fiscal 2005 include the operations and cash flows of SRDS through the dates the sales were completed.

The Company engaged the services of Direct Marketing Solutions, Inc., or DMS, for a substantial portion of its direct mail advertising. Direct Marketing Solutions, Inc. is partially owned (less than 50%) by the Stephens Group Inc., members of the Stephens family, Jon Jacoby, and Doug Martin. The Stephens Group Inc. and the members of the Stephens family are significant shareholders of the Company, and Jon Jacoby and Doug Martin are members of the Company's Board of Directors. The fees the Company paid to DMS during fiscal years ended 2005 and 2006 amounted to approximately \$1.8 million and \$4.3 million, respectively. Thomas J. Frank, the Chief Executive Officer and Chairman of the Board of Directors owned a small percentage (0.7%) at the end of fiscal year 2005, but divested his interest during the first half of fiscal year 2006.

## 10. Benefit Plans

The Company has established a defined contribution 401(k) plan for eligible employees who are at least 21 years old and have completed at least one-year of service. Employees may contribute up to 20% of their eligible pretax compensation to the plan. The Company will match 100% of the first 3% of the employees' contributions and 50% of the next 2% of the employees' contributions. Employees at least 50 years of age may make supplemental contributions to the Plan as defined by current regulations. At its option, the Company may also make supplemental contributions to the Plan, but has not made such

contributions in the past three years. The matching contributions made by the company totaled \$1.2, \$1.4 and \$1.6 million during the years ended January 31, 2004, 2005 and 2006, respectively.

## 11. Common and Preferred Stock

The Company has outstanding 23,571,564 shares of common stock at January 31, 2006, of which 7,000 shares are restricted as to various vesting rights until July 2006.

As part of the Company's recapitalization and reorganization that took place in 1998, a total of 213,720 shares of preferred stock were issued in exchange for existing common stock of the Company; such shares were valued as of the date of the transaction at \$87.18 per share and bore a cumulative dividend of 10% that was not payable until declared by the Company's board of directors. Such cumulative dividends must be paid before dividends on the common stock can be distributed. On January 24, 2003, the board of directors declared a preferred stock dividend as of April 30, 2003 in the amount of \$8.8 million (\$50.53 per share) contingent upon the completion of a proposed initial public offering. On December 1, 2003 when the initial public offering was closed, the Company redeemed all preferred stock and accumulated dividends for 1,711,832 shares of common stock and \$1.5 million in cash.

The table below reflects the number of preferred shares the Company redeemed during the periods covered and the total costs of the redemptions including accumulated dividends (dollars in thousands):

<u>Year ended January 31,</u>	<u>Redeemed</u>	<u>Costs</u>	<u>Dividends</u>
2004.....	174,648	\$25,420	\$10,194
2005.....	-	-	-
2006.....	-	-	-

## 12. Contingencies

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

**Insurance.** Because of its inventory, vehicle fleet and general operations, the Company has purchased insurance covering a broad variety of potential risks. The Company purchases insurance policies covering general liability, workers compensation, real property, inventory and employment practices liability, among others. Additionally, the Company has umbrella policies with an aggregate limit of \$50.0 million. The Company has retained a portion of the risk under these policies and its group health insurance program. See additional discussion under Note 1. The Company has a \$3.0 million letter of credit outstanding supporting its obligations under the property and casualty portion of its insurance program.

**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 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 sales and recorded in revenues in the statement of operations over the life of the agreements. The amounts deferred are reflected on the face of the balance sheet in "Deferred revenues and allowances," see also Note 1 for additional discussion.

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

None

**ITEM 9A. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

In accordance with Rules 13a-15 and 15d-15 under the Securities Exchange Act of 1934, we have evaluated, under the supervision and with the participation of management, including our Chief Executive Officer and our Chief Financial Officer, the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this annual report. Based on that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that, as of the end of the period covered by this annual report, our disclosure controls and procedures were effective in timely alerting them to material information relating to our business (including our consolidated subsidiaries) required to be included in our Exchange Act filings.

**Management's Report on Internal Control over Financial Reporting**

Please refer to Management's Report on Internal Control over Financial Reporting on page 49 of this report.

**Changes in Internal Controls Over Financial Reporting**

There have been no changes in our internal controls over financial reporting that occurred in the quarter ended January 31, 2006, which have materially affected, or are reasonably likely to materially affect our internal controls over financial reporting.

**ITEM 9B. OTHER INFORMATION**

None

### PART III

The information required by Items 10 through 14 is included in our definitive Proxy Statement relating to our 2006 Annual Meeting of Stockholders, and is incorporated herein by reference.

#### CROSS REFERENCE TO ITEMS 10-14 LOCATED IN THE PROXY STATEMENT

	Item	Caption in the Conn's, Inc. 2006 Proxy Statement
ITEM 10.	DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT	BOARD OF DIRECTORS, EXECUTIVE OFFICERS
ITEM 11.	EXECUTIVE COMPENSATION	EXECUTIVE COMPENSATION
ITEM 12.	SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT	STOCK OWNERSHIP OF DIRECTORS, EXECUTIVE OFFICERS AND PRINCIPAL STOCKHOLDERS
ITEM 13.	CERTAIN RELATIONSHIPS AND RELATED TRANSACTION	CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS
ITEM 14.	PRINCIPAL ACCOUNTANT FEES AND SERVICES	INDEPENDENT PUBLIC ACCOUNTANTS

## PART IV

### ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.

(a) The following documents are filed as a part of this report:

(1) The financial statements listed in response to Item 8 of this report are as follows:

Consolidated Balance Sheets as of January 31, 2005 and 2006

Consolidated Statements of Operations for the Years Ended January 31, 2004, 2005 and 2006

Consolidated Statements of Stockholders' Equity for the Years Ended January 31, 2004, 2005 and 2006

Consolidated Statements of Cash Flows for the Years Ended January 31, 2005 and 2006

- (2) Financial Statement Schedule: Report of Independent Auditors on Financial Statement Schedule for the three years in the period ended January 31, 2006; Schedule II -- Valuation and Qualifying Accounts. The financial statement schedule should be read in conjunction with the consolidated financial statements in our 2006 Annual Report to Stockholders. Financial statement schedules not included in this report have been omitted because they are not applicable or the required information is shown in the consolidated financial statements or notes thereto.
- (3) Exhibits: A list of the exhibits filed as part of this report is set forth in the Index to Exhibits, which immediately precedes such exhibits and is incorporated herein by reference.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.**

(Registrant)

/s/ Thomas J. Frank, Sr.

Date: March 30, 2006

Thomas J. Frank, Sr.

Chairman of the Board and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
/s/ Thomas J. Frank, Sr. Thomas J. Frank, Sr.	Chairman of the Board and Chief Executive Officer (Principal Executive Officer)	March 30, 2006
/s/ David L. Rogers David L. Rogers	Chief Financial Officer (Principal Financial and Accounting Officer)	March 30, 2006
/s/ Marvin D. Brailsford Marvin D. Brailsford	Director	March 30, 2006
/s/ Jon E.M. Jacoby Jon E.M. Jacoby	Director	March 30, 2006
/s/ Bob L. Martin Bob L. Martin	Director	March 30, 2006
/s/ Douglas H. Martin Douglas H. Martin	Director	March 30, 2006
/s/ Scott L. Thompson Scott L. Thompson	Director	March 30, 2006
/s/ William T. Trawick William T. Trawick	Director	March 30, 2006
/s/ Theodore M. Wright Theodore M. Wright	Director	March 30, 2006

## EXHIBIT INDEX

<u>Exhibit Number</u>	<u>Description</u>
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 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 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). <sup>†</sup>
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 Commission on June 7, 2004). <sup>†</sup>
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 and Exchange Commission on April 5, 2005). <sup>†</sup>
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). <sup>†</sup>
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). <sup>†</sup>
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). <sup>†</sup>
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

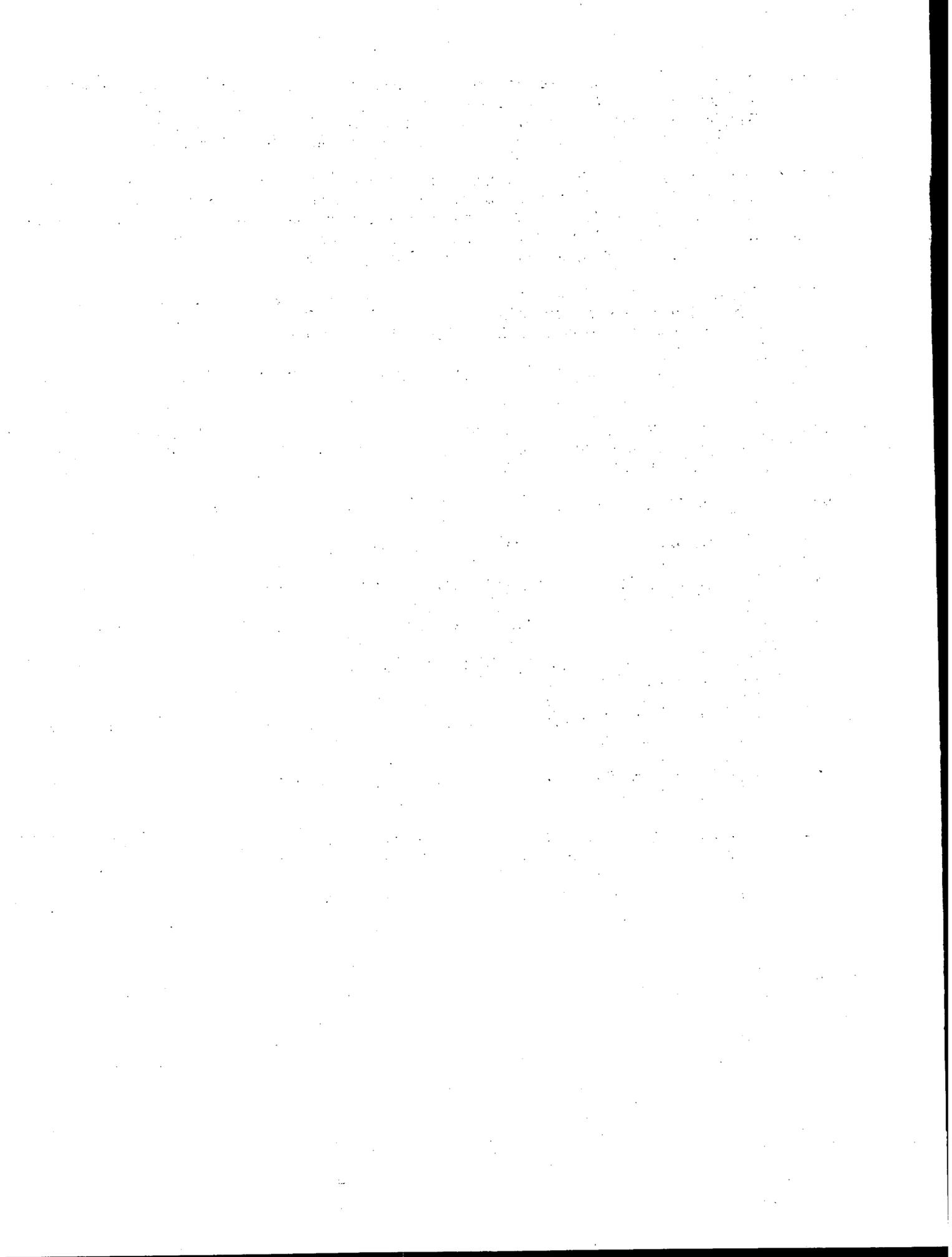
Exchange Commission on September 23, 2003).<sup>1</sup>

- 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 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 Commission on November 17, 2004).

- 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).
- 10.11 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 10.11 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 Commission on November 4, 2004).
- 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).
- 10.13 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).
- 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 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 July 31, 2005 (File No. 000-50421) as filed with the Securities and Exchange Commission on August 30, 2005).
- 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).
- 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).
- 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).
- 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).
- 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).
- 10.19 Dealer Agreement between Conn Appliances, Inc. and Voyager Service Programs, Inc. effective as of January 1, 1998 (filed herewith).
- 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 (filed herewith).
- 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 (filed herewith).
- 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 (filed herewith).
- 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 (filed herewith).
- 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 (filed herewith).
- 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 (filed herewith).

- 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 (filed herewith).
- 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 (filed herewith).
- 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 (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).
- 23.1 Consent of Ernst & Young LLP (filed herewith).
- 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.



UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

SCHEDULE 14A  
Proxy Statement Pursuant to Section 14(a) of the Securities  
Exchange Act of 1934

Filed by the Registrant:

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement  Confidential, for use of the Commission only  
(as permitted by Rule 14a-6(e)(2))
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to Rule 14a-12

**Conn's, Inc.**

(Name of Registrant as Specified in Its Charter)

N/A

(Name of Person(s) Filing Proxy Statement, if Other Than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

1) Title of each class of securities to which transaction applies:

2) Aggregate number of securities to which transaction applies:

3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

4) Proposed maximum aggregate value of transaction:

5) Total fee paid:

Fee paid previously with preliminary materials.

Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the form or schedule and the date of its filing.

1) Amount Previously Paid:

2) Form, Schedule or Registration Statement No.:

3) Filing Party:

4) Date Filed:

CONN'S, INC.  
3295 College Street  
Beaumont, Texas 77701  
(409) 832-1696

**NOTICE OF 2006 ANNUAL MEETING OF STOCKHOLDERS  
To Be Held May 31, 2006**

To the Stockholders of Conn's, Inc.:

NOTICE IS HEREBY GIVEN that the 2006 annual meeting of stockholders of Conn's, Inc. will be held on Wednesday, May 31, 2006, at 3295 College Street, Beaumont, Texas 77701, commencing at 10:00 a.m. local time, for the following purposes:

1. to elect nine (9) directors;
2. to consider a proposal to approve an amendment to the Conn's, Inc. Amended and Restated 2003 Incentive Stock Option Plan to provide for an increase in maximum number of shares with respect to which options may be granted to employees of the Company;
3. to consider a proposal to approve an amendment to the Conn's, Inc. 2003 Non-Employee Director Stock Option Plan to provide for (i) an increase in the maximum number of shares of Company stock with respect to which options may be granted to non-employee directors under and pursuant to the 2003 Non-Employee Director Stock Option Plan, and (ii) to provide for vesting of the annual grant of options to non-employee directors one year after the date of the grant ; and
4. to transact such other business as may properly come before the meeting.

A copy of the proxy statement relating to the 2006 annual meeting of stockholders, in which the foregoing matters are described in more detail, and our Annual Report on Form 10-K outlining our operations for the fiscal year ended January 31, 2006, accompanies this notice of 2006 annual meeting of stockholders. For your additional convenience, the Company is posting a copy of this Proxy Statement and the Annual Report on Form 10-K for the fiscal year ended January 31, 2006 on the Company's website at [www.conns.com](http://www.conns.com), under "annual meeting information".

Only stockholders of record at the close of business on April 14, 2006 are entitled to notice of and to vote at the 2006 annual meeting of stockholders or any adjournment thereof. A list of such stockholders, arranged in alphabetical order and showing the address of and the number of shares registered in the name of each such stockholder, will be available for examination by any stockholder for any purpose relating to the meeting during ordinary business hours for a period of at least ten days prior to the meeting at the principal offices of the Company located at 3295 College Street, Beaumont, Texas 77701.

**Your vote is important. Whether or not you expect to be present at the meeting, please complete, sign, date and return promptly the enclosed form of proxy in the enclosed pre-addressed, postage-paid return envelope.**

By Order of the Board of Directors,

/s/ Sydney K. Boone, Jr.  
SYDNEY K. BOONE, JR.  
Secretary

April 25, 2006  
Beaumont, Texas

This proxy statement is first being mailed to our stockholders on or about April 28, 2006.



**PROXY STATEMENT**

**2006 ANNUAL MEETING OF STOCKHOLDERS**

- Date:** May 31, 2006
- Time:** 10:00 a.m. local time
- Location:** Conn's, Inc., 3295 College Street, Beaumont, Texas 77701
- Record Date and Number of Votes:** April 14, 2006. Holders of our common stock are entitled to one vote for each share of common stock they owned as of the close of business on April 14, 2006. You may not cumulate votes.
- Agenda:**
1. to elect nine directors;
  2. to consider a proposal to approve an amendment to the Conn's, Inc. Amended and Restated 2003 Incentive Stock Option Plan to provide for an increase in maximum number of shares with respect to which options may be granted to employees of the Company;
  3. to consider a proposal to approve an amendment to Conn's, Inc. 2003 Non-Employee Director Stock Option Plan to provide for (i) an increase in the maximum number of shares of Company stock with respect to which options may be granted to non-employee directors under and pursuant to the 2003 Non-Employee Director Stock Option Plan, and (ii) to provide for vesting of the annual grant of options to non-employee directors one year after the date of the grant; and
  4. to transact such other business as may properly come before the meeting.
- Proxies:** Unless you tell us on the enclosed form of proxy to vote differently, we will vote signed returned proxies "FOR" the board nominees, "FOR" approval of the amendment to our incentive stock option plan, and "FOR" approval of the amendment to the non-employee director stock option plan. The proxy holders will use their discretion on other matters. If a nominee cannot or will not serve as a director, the proxy holders will vote for a person whom they believe will carry on our present policies.
- Proxies Solicited By:** The Board of Directors
- First Mailing Date:** We are first mailing this Proxy Statement and the form of proxy on or about April 28, 2006.
- Revoking Your Proxy:** You may revoke your proxy before it is voted at the meeting. To revoke your proxy, follow the procedures listed on page 2 under "General Information Regarding the 2006 Annual Meeting of Stockholders; Revocation of Proxies."

**PLEASE VOTE BY RETURNING YOUR PROXY. YOUR VOTE IS IMPORTANT.**  
Prompt return of your proxy will help reduce the costs of re-solicitation.

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## **GENERAL INFORMATION REGARDING THE 2006 ANNUAL MEETING OF STOCKHOLDERS**

### **Quorum**

The holders of a majority of the outstanding shares of common stock entitled to vote at the 2006 annual meeting of stockholders, represented in person or by proxy, will constitute a quorum at the meeting. However, if a quorum is not present or represented at the meeting, the stockholders entitled to vote at the meeting, present in person or represented by proxy, have the power to adjourn the meeting, without notice, other than by announcement at the meeting, until a quorum is present or represented. At any such adjourned meeting at which a quorum is present or represented, any business may be transacted that might have been transacted at the original meeting.

### **Votes Required to Approve Proposals**

To be elected, directors must receive a plurality of the shares voting in person or by proxy, provided a quorum exists. A plurality means receiving the largest number of votes, regardless of whether that is a majority. The amendment to our incentive stock option plan and our non-employee director stock plan requires the affirmative vote of a majority of the shares entitled to vote that are present in person or represented by proxy at the meeting.

### **Record Date, Shares Outstanding and Number of Votes**

Only stockholders of record as of the close of business on April 14, 2006, the record date set for the meeting by our board, are entitled to notice of and to vote at the meeting or any adjournments of the meeting. On the record date, there were 23,634,662 shares of our common stock issued and outstanding and entitled to vote. Each share of common stock entitles the holder to one vote per share.

### **Method of Counting Votes, Abstentions and Broker Non-Votes**

Votes cast by proxy or in person will be counted by the inspector of election appointed by the Company.

Those who fail to return a proxy or who do not attend the meeting will not count towards determining any required quorum, plurality or majority of votes cast. Stockholders and brokers returning proxies or attending the meeting who abstain from voting on the election of directors will count towards determining a quorum. Such abstentions will have no effect on the election of our directors and will have the effect of a "no" vote on the proposal to amend our incentive stock option plan and our non-employee director stock option plan, but will not impact how the shares in the Conn's Voting Trust are voted, which votes in the same proportion as the votes cast "for" and "against" a proposal by all other shareholders, not counting abstentions.

Brokers holding shares of record for customers generally are not entitled to vote on certain matters unless they receive voting instructions from their customers. Brokers are permitted to vote on routine, non-controversial proposals in instances where they have not received voting instructions from the beneficial owner of the stock but are not permitted to vote on non-routine matters. In the event that a broker does not receive voting instructions for non-routine matters, a broker may notify us that it lacks voting authority to vote those shares. These "broker non-votes" refer to votes that could have been cast on the matter in question by brokers with respect to uninstructed shares if the brokers had received their customers' instructions. The inspector of election will treat broker non-votes as shares that are present and entitled to vote for the purpose of determining the presence of a quorum. However, for the purpose of determining the outcome of any matter as to which the broker has indicated on the proxy that it does not have discretionary authority to vote, those shares will be treated as not present and not entitled to vote with respect to that matter (even though those shares are considered entitled to vote for quorum purposes and may be entitled to vote on other matters). Approval of or amendments to equity compensation plans like our incentive stock option plan and our non-employee director stock plan proposals are generally considered non-routine matters. These broker non-votes will have no effect on the outcome of the election of our directors or the proposals to amend our incentive stock option plan and non-employee director stock option plan.

## How the Proxies Will Be Voted

The enclosed proxies will be voted in accordance with the instructions you place on the form of proxy. Unless you tell us on the enclosed form of proxy to vote differently, we will vote signed returned proxies "FOR" the board nominees, "FOR" approval of the amendment to our incentive stock option plan, and "FOR" approval of the amendment to the non-employee director stock option plan. The proxy holders will use their discretion on other matters. If a nominee cannot or will not serve as a director, the proxy holders will vote for a person whom they believe will carry on our present policies.

Pursuant to the terms of a voting trust agreement entered into by Stephens Group, Inc., Stephens Inc. and certain affiliates of Stephens Inc., which collectively own approximately 47.9% of our common stock, unless the voting trust is revoked, the trustee of the voting trust must vote the shares of common stock held by the voting trust "FOR" or "AGAINST" any proposal or other matter submitted to the stockholders of the company for approval in the same proportion as the votes cast "FOR" and "AGAINST" such proposal or other matter by all other stockholders, not counting abstentions. Therefore, each proxy received voting "FOR" or "AGAINST" any proposal will result in a proportionate number of shares held in the voting trust to be voted "FOR" or "AGAINST" a proposal. Abstentions and broker non-votes will not impact how the shares in the voting trust are counted.

## Revocation of Proxies

You may revoke your proxy before it is voted. Any stockholder returning the enclosed form of proxy may revoke such proxy at any time prior to its exercise by:

- delivering a signed proxy, dated later than the original proxy, to our transfer agent, Computershare, at 250 Royall Street, Canton, Massachusetts 02021, Attention: Jay Volner (please make sure our transfer agent receives your proxy at least two business days prior to the date of the meeting);
- delivering a signed, written revocation letter, dated later than the proxy, to our transfer agent, Computershare, at 250 Royall Street, Canton, Massachusetts 02021, Attention: Jay Volner (please make sure our transfer agent receives your revocation letter at least two business days prior to the date of the meeting); or
- attending the meeting and voting in person (attending the meeting alone will not revoke your proxy).

Your last vote is the vote that will be counted.

## Stockholder Proposals and Other Business

From time to time, stockholders seek to nominate directors or present proposals for inclusion in our proxy statement and form of proxy for consideration at an annual meeting of stockholders. To be included in our proxy statement and form of proxy or considered at our next annual meeting, you must timely submit nominations of directors or proposals, in addition to meeting other legal requirements. We must receive your nominations and/or proposals for the 2007 annual meeting no later than December 29, 2006 for possible inclusion in the proxy statement or for possible consideration at the meeting no earlier than December 29, 2006 or later than January 29, 2007. However, if the date of the 2006 annual meeting changes by more than 30 days from the date of this year's meeting, then we must receive your nominations and/or proposals within a reasonable time before we begin to print and mail our proxy materials.

We do not intend to bring any business before the 2006 annual stockholders meeting other than the matters described in this proxy statement nor have we been informed of any matters that may be presented at the meeting by others. If however, any other business should properly arise, the persons appointed in the enclosed proxy have discretionary authority to vote in accordance with their best judgment.

## **Solicitation of Proxies**

The cost of soliciting proxies will be borne by the Company. In addition to the solicitation of proxies by mail, solicitation may be made by our directors, officers and employees by other means, including telephone, email or in person. No special compensation will be paid to directors, officers or employees for the solicitation of proxies. To solicit proxies, we also will request the assistance of banks, brokerage houses and other custodians, nominees or fiduciaries, and, upon request, will reimburse such organizations or individuals for their reasonable expenses in forwarding soliciting materials to beneficial owners and in obtaining authorization for the execution of proxies.

## **Annual Report**

The booklet containing this proxy statement also contains our annual report to stockholders and Form 10-K including audited consolidated financial statements for the year ended January 31, 2006. The booklet has been mailed to all stockholders of record as of the close of business on April 14, 2006. Any stockholder that has not received a copy of our annual report may obtain a copy, without charge, by writing to us at 3295 College Street, Beaumont, Texas 77701, Attention: Sydney K. Boone, Jr., Corporate General Counsel. You may also obtain a copy of this proxy statement and Form 10-K together with all of our SEC filings through the Company's website at [www.conns.com](http://www.conns.com) and at the SEC's website at [www.sec.gov](http://www.sec.gov).

## **PROPOSALS FOR STOCKHOLDER ACTION**

### **PROPOSAL ONE: ELECTION OF DIRECTORS**

#### **Number of Directors To Be Elected**

Our board is currently constituted with nine director positions, all of which positions are to be elected at the 2006 annual meeting of stockholders. The nine directors elected at the annual meeting will hold office until the 2007 annual meeting of stockholders or until their respective successors have been elected and qualified. You may not vote for a greater number of directors than those nominated.

#### **Expansion of Board; Board Nominees**

Our board of directors met in March 2006 and considered and did approve the expansion of the number of director positions from eight to nine positions, and additionally considered the candidates for election to the board at the 2006 annual meeting. A majority of our independent directors recommended that the board nominate:

Thomas J. Frank, Sr.  
Marvin D. Brailsford  
Jon E.M. Jacoby  
Bob L. Martin  
Douglas H. Martin  
Dr. William C. Nylin, Jr.  
Scott L. Thompson  
William T. Trawick  
Theodore M. Wright

for re-election to the Board at the 2006 annual meeting. In making these recommendations, the independent directors considered the requirements and qualifications discussed under "Board of Directors; Nominating Policies" on page 16 of this proxy statement. Based on this recommendation, our board has nominated:

Thomas J. Frank, Sr.  
Marvin D. Brailsford  
Jon E.M. Jacoby  
Bob L. Martin  
Douglas H. Martin  
Dr. William C. Nylin, Jr.  
Scott L. Thompson  
William T. Trawick  
Theodore M. Wright

to be elected by the stockholders at the 2006 annual meeting. All nominees have consented to serve as directors. The board has no reason to believe that any of the nominees will be unable or unwilling to act as a director. In the event any of these nominated directors is unable to stand for election, the board of directors may either reduce the size of the board or designate a substitute.

For biographical information regarding each of the board's nominees for director, please refer to "Board of Directors; Board Nominees" on page 14 of this proxy statement.

**We Recommend That You Vote For Each Of The Board Nominees.**

**PROPOSAL TWO:  
APPROVAL OF THE AMENDMENT TO THE AMENDED AND RESTATED 2003 INCENTIVE STOCK  
OPTION PLAN**

Effective January 2003, our board of directors adopted the Conn's, Inc. Amended and Restated 2003 Incentive Stock Option Plan. The plan was approved by our stockholders at the January 17, 2003 special meeting of the stockholders of Conn Appliances, Inc., our predecessor corporation. At the annual meeting of stockholders held June 3, 2004, an amendment to the plan was approved by the stockholders of the Company requiring the plan to be administered by the Board or a committee appointed by the Board, which committee is to be constituted to comply with Applicable Laws and permitting the Chief Executive Officer of the Company the authority to grant options to non-executive officers of the Company under guidelines or formulae approved or adopted by the committee. The purpose of the plan is to secure for Conn's and our stockholders the benefits of the incentives inherent in the ownership of our common stock by our present and future employees. On March 28, 2006, our board of directors, subject to shareholder approval, amended our 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.

**General Description of the Plan**

Under the plan, officers and employees are eligible to receive awards in the form of stock options. As of January 31, 2006, we had approximately 2,600 full-time employees and 200 part-time employees. Generally, the plan is for ten years subject to early termination. If this proposal to amend the plan is adopted, the term of the plan will be increased until March 29, 2016, 10 years from the date our board of directors adopted the amendment increasing the number of shares reserved for issuance under the plan. Copies of the full text of the plan are available for review at our principal offices and we will furnish copies to our stockholders without charge upon written request directed to Conn's, Inc., 3295 College Street, Beaumont, Texas 77701, Attention: Chief Financial Officer. Further, for your convenience, a copy of the plan is posted on the Company's website at [www.conns.com](http://www.conns.com), under "annual meeting documents".

Options granted under the plan may be either incentive stock options or non-qualified stock options. Subject to early termination provisions, options may have a term of up to 10 years, provided, however, an option granted to an employee who owns stock representing more than 10% of the voting power of our stock on the date of the grant may not have a term greater than five years. Each option generally vests in twenty percent increments commencing on the first annual anniversary of the grant date unless otherwise provided in the option agreement. However, the vesting may accelerate under certain conditions. The exercise price for the incentive stock options is to be not less than the fair market value of the underlying stock on the date of the grant unless the option is being granted to an employee who, at the date of grant, owns more than 10% of our voting power, in which case, the exercise price is not to be less than 110% of the fair market value. The exercise price for non-qualified stock options is determined by our compensation committee, as the administrator of the plan. Options granted under the plan may not be sold, pledged, assigned, or otherwise disposed of other than by will or by the laws of descent or distribution. During the lifetime of the employee to whom the option was granted, the option may only be exercised by that employee.

The plan, prior to the amendment, provides for 2,559,767 shares of Company common stock available for issuance. At January 31, 2006, a total of 1,625,556 shares of common stock were subject to options issued and outstanding under the plan, 481,262 outstanding options had been exercised, and 452,949 shares remain available for issuance under the plan. If this proposal had been adopted on January 31, 2006, there would have been 1,754,949 shares available for issuance at January 31, 2006. All of the shares authorized for issuance under the plan that have been approved by the stockholders are registered on a Form S-8 filed with the SEC. If this proposal is adopted, we intend to file a new registration statement on Form S-8 to cover the registration of the additional shares.

**Administration**

The plan is administered by our board of directors and the compensation committee of our board. Except as provided in the NASD exemptions, the members of the compensation committee must be "non-employee directors" as defined in Rule 16b-3 under the Securities Exchange Act of 1934 and "outside directors" as required under Section 162(m) of the Internal Revenue Code of 1986, as amended. Our

compensation committee currently consists of Jon E.M. Jacoby, Theodore M. Wright and William T. Trawick, who are independent directors.

The board or the compensation committee has discretion in determining the terms, restrictions and conditions of each award granted under the plan. The board or the compensation committee is permitted, in its discretion, to change and/or rescind the terms of any award granted under the plan as long as such change or rescission does not adversely affect the rights of the award recipient as stated in the applicable award agreement.

### **Amendment**

The plan may be amended or terminated by the board or the compensation committee at any time. However, an amendment that would impair the rights of a recipient of any outstanding award will not be valid with respect to such award without the recipient's consent. In addition, our stockholders must approve any amendment to increase the number of authorized shares under the plan, to change employees eligible to participate in the plan, to change the manner in which options are issued or exercised, to extend the term of the plan or to adopt any amendment which requires stockholder approval under NASD rules.

### **Proposed Amendment to the Plan**

We proposed to amend the plan as follows:

The first paragraph of Section 4 of the plan will be amended and restated to read as follows:

"4. Shares Subject to this Plan. Subject to the provisions of Paragraph 13, the maximum aggregate number of Shares that may be subject to Options and sold under this Plan is 3,859,767. The Shares may be authorized but unissued or reacquired Common Stock."

Section 6(a) of the plan will be amended and restated to read as follows:

"(a) Options may be granted only to Employees. The maximum number of Shares with respect to which Options may be granted during a specified period to any single Employee is 500,000."

The remaining provisions of the plan will remain the same and in full force and effect.

### **Purposes of the Amendment**

One of the purposes of the proposed amendment to the plan is to (i) ensure that the plan has sufficient shares for issuance, and (ii) ensure that compensation related to stock options granted under the plan is considered performance-based compensation that is excluded from the \$1.0 million deduction limit of Section 162(m) of the Internal Revenue Code and therefore remains fully deductible. Section 162(m) requires that (i) the grant must be made by the compensation committee; (ii) the plan under which the option is granted states the maximum number of shares with respect to which options may be granted during a specified period (usually a fiscal year or a calendar year) to any employee; and (iii) under the terms of the option, the amount of compensation the employee could receive is based solely on an increase in the value of the stock after the date of grant.

The other purpose of the amendment to the plan is to further promote our ability to attract and retain the best available personnel for positions of substantial responsibility; to provide additional incentive to our employees and to promote the success of the Company's business. Accordingly, the board of directors unanimously determined to propose to the stockholders the increase in the number of shares available for issuance under the plan, and the increase of the maximum number of shares with respect to which options may be granted during a specified period to any single employee.

## **Tax Effects of Participation in the Plan**

*The following is a brief summary of certain federal income tax consequences arising with respect to options granted under the plan. This summary is not intended to be exhaustive and the exact tax consequences to the participant will depend on various factors and his or her particular circumstances. The summary is based on present laws, regulations and interpretations and does not purport to be a complete description of federal tax consequences. This summary of federal tax consequences may change in the event of a change in the Internal Revenue Code or regulation thereunder or interpretations thereof. We urge participants to consult with a tax advisor with respect to any state, local or foreign tax considerations or particular federal tax implications of options granted under the plan prior to taking action with respect to an option. The plan is not intended to be a "qualified plan" under Section 401(a) of the Internal Revenue Code.*

### ***Withholding***

We may deduct from all amounts paid by us to the participant in cash or other form, any federal, state, or local taxes required by law to be withheld with respect to such payments. The participant receiving shares of common stock issued under the plan upon the exercise of options will be required to pay us the amount of any taxes which we are required to withhold with respect to such shares of common stock.

### ***Incentive Stock Options***

The grant or exercise of an incentive stock option will not result in ordinary taxable income to the participant or a tax deduction for us. However, when the option is exercised, the difference between the exercise price and the fair market value of the stock on the date of exercise will be considered income for the purposes of the alternative minimum tax. Accordingly, the exercise of an incentive stock option may result in an alternative minimum tax liability.

Shares acquired pursuant to the exercise of an incentive stock option ordinarily receive capital gain or loss treatment on their sale or other disposition. However, if the holder disposes of the shares acquired upon the exercise of an incentive stock option within two years after the date of grant or one year after the date of exercise (a "disqualifying disposition"), the holder will generally recognize ordinary income in the amount of the excess of the fair market value of the shares on the date the option exercised over the exercise price, and we will be entitled to a corresponding tax deduction, provided we comply with applicable income tax reporting requirements. Any excess of the amount realized by the holder on the disqualifying disposition over the fair market value of the shares on the date of exercise of the option will generally be a capital gain.

If an option is exercised through the use of shares previously owned by the holder, such exercise generally will not be considered a taxable disposition of the previously owned shares and thus no gain or loss will be recognized with respect to those shares upon such exercise.

### ***Non-qualified Stock Options***

Some of the options granted under the plan may be non-qualified stock options, that is, options not intended to be incentive stock options within the meaning of Section 422 of the Internal Revenue Code.

There are no tax consequences to the participant or us by reason of the grant of a non-qualified stock option. Upon exercise of a non-qualified stock option, the participant normally will recognize taxable ordinary income equal to the excess, if any, of the stock's fair market value on the date the non-qualified stock option is exercised over the exercise price of the option. Upon disposition of the stock, the participant will recognize a gain or loss equal to the difference between the amount realized as a result of the sale and the sum of the exercise price plus any amount recognized as ordinary income when the non-qualified stock option was exercised or, if later, when the shares subject to the non-qualified stock option are no longer subject to a substantial risk of forfeiture. Such gain or loss will be long-term or short-term depending on whether the stock was held for more than the applicable capital gains holding period.

If we comply with applicable income reporting requirements, we will be entitled to a federal income tax deduction in the same amount and at the same time as the participant recognizes ordinary income, subject to any deduction limitation under Section 162(m) of the Internal Revenue Code, which is discussed below.

**Section 162(m)**

Section 162(m) of the Internal Revenue Code generally disallows a public company's tax deduction for compensation paid in excess of \$1.0 million in any tax year to its chief executive officer, or the individual acting in that capacity, and the four most highly compensated executives. However, compensation that qualifies as "performance-based compensation" is excluded from this \$1.0 million deduction limit and therefore remains fully deductible by the company that pays it. We intend that options granted (i) with an exercise price at least equal to 100% of the fair market value of the underlying shares of common stock at the date of grant and (ii) to employees the compensation committee expects to be named executive officers at the time a deduction arises in connection with these options, qualify as "performance-based compensation" so these options will not be subject to the Section 162(m) deduction limitation.

## Options Granted Under the Amended and Restated 2003 Incentive Stock Option Plan

As of January 31, 2006, the closing sale price of our common stock was \$43.48 per share, as reported by Nasdaq. The following table sets forth information with respect to options granted to the listed persons and groups under the plan through January 31, 2006.

Name and Principal Position	Number Of Shares Underlying Options	Grant Date	Exercise Price	Expiration Date
Thomas J. Frank, Sr.,	25,000	11/30/2005	\$ 33.88	11/30/2015
Chairman of the Board and Chief Executive Officer	35,000	11/30/2004	\$ 17.73	11/30/2014
	56,500	11/25/2003	\$14.00	11/25/2003
Dr. William C. Nylín, Jr.,	15,000	11/30/2005	\$33.88	11/30/2015
Executive Vice Chairman of the Board	35,000	11/30/2004	\$17.73	11/30/2014
and Chief Operating Officer	56,500	11/25/2003	\$14.00	11/25/2013
	28,070	7/15/2001	\$8.21	7/15/2011
David W. Trahan,	15,000	11/30/2005	\$33.88	11/30/2015
Senior Vice President-Retail	10,000	11/30/2004	\$17.73	11/30/2014
	8,000	11/25/2003	\$14.00	11/24/2013
Reymundo de la Fuente, Jr.	15,000	11/30/2005	\$ 33.88	11/30/2015
Senior Vice President-Credit	10,000	11/30/2004	\$ 17.73	11/30/2014
	8,000	11/25/2003	\$14.00	11/24/2013
	42,000	7/15/2001	\$8.21	7/15/2011
	28,000	1/25/2001	\$8.21	1/25/2011
	28,000	7/28/2000	\$8.21	7/28/2010
Timothy L. Frank	15,000	11/30/2005	\$33.88	11/30/2015
President	10,000	11/30/2004	\$17.73	11/30/2014
	8,000	11/25/2003	\$14.00	11/25/2013
	56,140	7/15/2001	\$8.21	7/15/2011
Executive officers as a group	155,000	11/30/2005	\$33.88	11/30/2015
	160,000	11/30/2004	\$17.73	11/30/2014
	184,500	11/25/2003	\$14.00	11/25/2013
	231,210	7/15/2001	\$8.21	7/15/2011
	94,500	1/25/2001	\$8.21	1/25/2011
	49,000	7/28/2000	\$8.21	7/28/2010
All employees (excluding executive officer group)	98,700	11/30/2005	\$33.88	11/30/2015
	131,300	11/30/2004	\$17.73	11/30/2014
	15,000	10/6/2004	\$14.48	10/6/2014
	37,900	5/26/2004	\$16.49	5/26/2014
	142,300	11/25/2003	\$14.00	11/25/2013
	56,000	6/28/2002	\$10.83	6/28/2012
	17,250	12/3/2001	\$9.91	12/3/2011
	28,000	8/1/2001	\$8.21	8/1/2011
	171,808	7/15/2001	\$8.21	7/15/2011
	171,500	1/25/2001	\$8.21	1/25/2011
	255,500	7/28/2000	\$8.21	7/28/2010
	17,500	1/10/2000	\$4.29	1/10/2010
	35,000	12/1/1999	\$4.29	12/1/2009

**Equity Compensation Plan Information Prior to Stockholder Approval of the Amendment to the Plan.**

The following table provides information about our common stock that may be issued upon the exercise of options under all of our existing equity compensation plans as of January 31, 2006.

<b>Plan Category</b>	<b>(A) Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights</b>	<b>(B) Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights</b>	<b>(C) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (A))</b>
Equity Compensation Plans Approved by Stockholders	1,625,556	\$16.31	452,949
Equity Compensation Plans Not Approved by Stockholders	-	-	-
<b>Total</b>	<b>1,625,556</b>	<b>\$16.31</b>	<b>452,949</b>

**We Recommend That You Vote For Approval Of The Amendment To The Conn's, Inc. Amended and Restated 2003 Incentive Stock Option Plan.**

**PROPOSAL THREE:  
APPROVAL OF THE AMENDMENT TO THE 2003 NON-EMPLOYEE DIRECTOR STOCK OPTION  
PLAN**

Effective January 2003, our board of directors adopted the Conn's, Inc. 2003 Non-Employee Directors Stock Option Plan. The plan was approved by our stockholders at the January 17, 2003 special meeting of the stockholders of Conn Appliances, Inc., our predecessor corporation. The purpose of the plan is to attract and retain persons of outstanding competence to serve on the board of directors who are not employed by the Company. On March 28, 2006, our board of directors, subject to shareholder approval, amended our 2003 Non-Employee Director 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, and to provide for the vesting of the annual option grants after the director's fourth anniversary as a director on the one year anniversary date of the issuance of such options.

**General Description of the Plan**

Under the plan, non-employee directors are awarded non-qualified stock options as specifically directed and required under the plan. We currently have seven non-employee directors. It is intended that there will be no tax consequences to the non-employee director or the Company by reason of the issuance of the options to the non-employee director. Upon election to the board, each non-employee director is awarded options to acquire 40,000 shares of Company common stock. Each non-employee director is also awarded options to purchase 10,000 shares of our common stock following each annual stockholder meeting after the fourth anniversary of each non-employee director's initial election or appointment to the board. Each option vests in twenty-five percent increments commencing on the first annual anniversary of the grant date, unless otherwise stated in the option agreement granting the options. Currently, each option agreement for all non-employee directors states that the options vest equally over a three year period. If a non-employee director resigns or is not reelected prior to the vesting of all of his/her options, the unvested portion of the options as well as all vested but unexercised within three years of the date of such resignation or non-election is returned to the shares available for issuance.

Options granted under the plan are non-qualified stock options. Subject to early termination provisions, options may have a term of up to 10 years. The exercise price for non-qualified stock options is determined by our board of directors, as the administrator of the plan. Options granted under the plan may not be sold, pledged, assigned, or otherwise disposed of other than by will or by the laws of descent or distribution. During the lifetime of the non-employee director to whom the option was granted, the option may only be exercised by that non-employee director.

The plan, prior to the amendment, provides and the Form S-8 filed with the SEC registered 300,000 shares of Company common stock for issuance under the plan. At January 31, 2006, each of the Company's seven non-employee directors have received the required, under the plan, options to 40,000 shares of company stock, for a total of 258,000 shares of common stock subject to options issued and outstanding under the plan, 22,000 outstanding options had been exercised, and 20,000 shares remain available for issuance subject to options under the plan. All of the shares authorized for issuance under the plan have been approved by the stockholders and are registered on a Form S-8 filed with the SEC. If this proposal had been adopted on January 31, 2006, there would have been 600,000 shares available for issuance at January 31, 2006. If this proposal is adopted, we intend to file a new registration statement on Form S-8 to cover the registration of the additional shares.

**Administration**

The plan is administered by our board of directors.

The board, as administrator of the plan, has discretion in determining the terms, restrictions and conditions of each award granted under the plan. The board is permitted, in its discretion, to change and/or rescind the terms of any award granted under the plan as long as such change or rescission does not adversely affect the rights of the award recipient as stated in the applicable award agreement.

## **Amendment**

The plan may be amended or terminated by the board at any time. However, an amendment that would impair the rights of a recipient of any outstanding award will not be valid with respect to such award without the recipient's consent. In addition, our stockholders must approve any amendment to increase the number of authorized shares under the plan, to change the manner in which options are issued or exercised, to extend the term of the plan or to adopt any amendment which requires stockholder approval under NASD rules.

### **Proposed Amendment to the Plan**

We proposed to amend the plan as follows:

The first paragraph of Paragraph 4 of the plan will be amended and restated to read as follows:

"4. Shares Subject to this Plan. Subject to the provisions of Paragraph 17, the maximum aggregate number of Shares that may be subject to Options and sold under this Plan is 600,000. The Shares may be authorized but unissued or reacquired Common Stock."

Paragraph 6(b) of the plan will be amended and restated, to read as follows:

Unless stated otherwise in the Option Agreement, Options granted under this Plan shall vest and become exercisable, subject to the other terms of this Plan, at the rate of 25% per annum on each anniversary of the Date of Grant, except that Options granted under this Plan pursuant to Paragraph 6(a)(ii) above shall vest on the first annual anniversary date of the Date of Grant."

The remaining provisions of the plan will remain the same and in full force and effect.

### **Purpose of the Amendment**

One of the purposes of the proposed amendment to the plan is to ensure that the plan has sufficient shares for its required issuance, plus discretionary issuance. Currently, as described above, the plan has 20,000 shares remaining for issuance subject to options. Six of the current directors, if they do not resign, are re-nominated and are reelected through the annual meeting in 2007, shall receive additional grants of 10,000 options each and an additional grant of 10,000 shares on each anniversary thereafter, as prescribed by the plan. A seventh director will be entitled to such additional 10,000 shares commencing in 2008, if he does not resign, is re-nominated and is reelected through the annual meeting in 2008. The number of shares available for issuance under the plan is not sufficient to support these requirements.

The other purpose of the amendment to the plan is to further promote our ability to attract and retain the best available persons for our board, to provide for discretionary granting rights by the board, at the instance of the compensation committee to issue non-employee director options for such purpose, and to provide for convenience in utilizing such discretion to bring before the full board the granting of such discretionary options.

### **Tax Effects of Participation in the Plan**

*The following is a brief summary of certain federal income tax consequences arising with respect to options granted under the plan. This summary is not intended to be exhaustive and the exact tax consequences to the participant will depend on various factors and his or her particular circumstances. The summary is based on present laws, regulations and interpretations and does not purport to be a complete description of federal tax consequences. This summary of federal tax consequences may change in the event of a change in the Internal Revenue Code or regulation thereunder or interpretations thereof. We urge participants to consult with a tax advisor with respect to any state, local or foreign tax considerations or particular federal tax implications of options granted under the plan prior to taking action with respect to an option. The plan is not intended to be a "qualified plan" under Section 401(a) of the Internal Revenue Code.*

### **Withholding**

Optionees may satisfy withholding tax obligations by electing to have the Company withhold from the shares to be issued upon exercise of an option that number of shares having a fair market value equal to the minimum amount required to be withheld. We may deduct from all amounts paid by us to the participant in cash or other form, any federal, state, or local taxes required by law to be withheld with respect to such payments. The participant receiving shares of common stock issued under the plan upon the exercise of options will be required to pay us the amount of any taxes which we are required to withhold with respect to such shares of common stock.

### **Non-qualified Stock Options**

All of the options granted under the plan may be non-qualified stock options, that is, options not intended to be incentive stock options within the meaning of Section 422 of the Internal Revenue Code.

There are no tax consequences to the participant or us by reason of the grant of a non-qualified stock option. Upon exercise of a non-qualified stock option, the participant normally will recognize taxable ordinary income equal to the excess, if any, of the stock's fair market value on the date the non-qualified stock option is exercised over the exercise price of the option. Upon disposition of the stock, the participant will recognize a gain or loss equal to the difference between the amount realized as a result of the sale and the sum of the exercise price plus any amount recognized as ordinary income when the non-qualified stock option was exercised or, if later, when the shares subject to the non-qualified stock option are no longer subject to a substantial risk of forfeiture. Such gain or loss will be long-term or short-term depending on whether the stock was held for more than the applicable capital gains holding period.

If we comply with applicable income reporting requirements, we will be entitled to a federal income tax deduction in the same amount and at the same time as the participant recognizes ordinary income.

### **Equity Compensation Plan Information Prior to Stockholder Approval of the Amendment to the Plan**

The following table provides information about our common stock that may be issued upon the exercise of options under the non-employee director stock option plan as of January 31, 2006.

<b>Plan Category</b>	<b>(A) Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights</b>	<b>(B) Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights</b>	<b>(C) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (A))</b>
Equity Compensation Plans Approved by Stockholders	258,000	\$14.36	20,000
Equity Compensation Plans Not Approved by Stockholders	-	-	-
<b>Total</b>	<b>258,000</b>	<b>\$14.36</b>	<b>20,000</b>

**We Recommend That You Vote For Approval Of  
The Amendment To The Conn's, Inc. 2003 Non-Employee Director  
Stock Option Plan.**

## BOARD OF DIRECTORS

### Board Nominees

Our board of directors met in March 2006 and considered the candidates for election to the board at the 2006 annual meeting. A majority of our independent directors recommended that the board nominate:

Thomas J. Frank, Sr.  
Marvin D. Brailsford  
Jon E.M. Jacoby  
Bob L. Martin  
Douglas H. Martin  
Dr. William C. Nylín, Jr.  
Scott L. Thompson  
William T. Trawick  
Theodore M. Wright

for re-election at the 2006 annual meeting. Based on this recommendation, our board has nominated:

Thomas J. Frank, Sr.  
Marvin D. Brailsford  
Jon E.M. Jacoby  
Bob L. Martin  
Douglas H. Martin  
Dr. William C. Nylín, Jr.  
Scott L. Thompson  
William T. Trawick  
Theodore M. Wright

to be elected by all of our stockholders.

**Thomas J. Frank, Sr.** was appointed as our Chairman of the Board and Chief Executive Officer in 1994. He has been employed by us for 46 years, has been a member of our board of directors since 1980 and has held every key management position within the organization, including responsibilities for distribution, service, credit, information technology, accounting and general operations. Mr. Frank holds a B.A. degree in industrial arts from Sam Houston State University and attended graduate courses at Texas A&M University. Mr. Frank completed the SCMP course at Harvard University. Mr. Frank is 66 years old.

**Marvin D. Brailsford** has served as a director since September 2003. From 1996 until 2002, General Brailsford served as Vice President-Material Stewardship Project Manager for the U.S. government's Rocky Flats Environmental Technology Site where he was responsible for managing engineered systems and commodities purchasing. From 1992 to 1996, General Brailsford was president of the Brailsford Group, Inc., a management consulting company, and served as president of Metters Industries, Inc., an information technology and systems engineering company, during this time period. In 1992, he retired from the U.S. Army as a Lieutenant General, after 33 years of service, most recently where he served as Deputy Commanding General Materiel Readiness/Executive Director for Conventional Ammunition at the U.S. Materiel Command in Alexandria, Virginia. Since 1996, General Brailsford has served on the board of directors of Illinois Tool Works, Inc. and has been a member of its audit committee and chairman of its corporate governance committee. He also serves or has served on the boards of directors of various private and governmental entities. General Brailsford earned a B.S. degree in biology from Prairie View A & M University and a M.S. degree in bacteriology from Iowa State University. He is also a graduate of the Executive Program at the Graduate School of Business Administration, University of California at Berkeley; Harvard University's John F. Kennedy School of Government; the U.S. Army Command and General Staff College; and the Army War College. General Brailsford is 67 years old.

**Jon E. M. Jacoby** has served as a director since April 2003. Mr. Jacoby is a director of Stephens Group, Inc. In September 2003, he retired as a Senior Executive Vice President of Stephens Inc., where

he had been employed since 1963. His positions included Investment Analyst, Assistant to the President and Manager of the Corporate Finance Department and the Special Investments Department for Stephens Group, Inc. Mr. Jacoby serves on the board of directors of Delta and Pine Land Company, Power-One, Inc., Sangamo BioSciences, Inc. and Eden Bioscience Corporation. He received his B.S. from the University of Notre Dame and his M.B.A. from Harvard Business School. Mr. Jacoby is 68 years old.

**Bob L. Martin** has served as director since September 2003. Mr. Martin has over 31 years of retailing and merchandising experience. Prior to retiring from the retail industry in 1999, he headed the international operations of Wal-Mart International, Inc. for 15 years. From 1968 to 1983 Mr. Martin was responsible for technology services for Dillard's, Inc. He currently serves on the board of directors of Dillard's, Inc., Gap, Inc., Sabre Holdings Corporation and Guitar Center, Incorporated. He has experience as chairman of the corporate governance committee and compensation committee, and has been a member of the audit committee of publicly held companies. Mr. Martin attended South Texas University and holds an honorary doctorate degree from Southwest Baptist University. Mr. Martin is 57 years old.

**Douglas H. Martin** has served as a director since 1998. Mr. Martin is an Executive Vice President of Stephens Group, Inc. and Stephens Inc., a wholly-owned subsidiary of Stephens Group, Inc., where he has been employed since 1981. He is responsible for the investment of the firm's capital in private companies. Mr. Martin serves as a member of the board of directors of numerous privately held companies. He received his B.A. in physics and economics from Vanderbilt University and his M.B.A. from Stanford University. Mr. Martin is 52 years old.

**Dr. William C. Nylin, Jr.** was appointed to our board as Executive Vice Chairman of the Board by the board of directors on March 28, 2006, to fill the newly created ninth board position. Dr. Nylin has served as our Chief Operating Officer since 1995. From 1995 until April 1, 2006, Dr. Nylin also served as our President. He was a member of our Board commencing in 1993, and remained a member until September 2003, when the Company became a publicly held entity. In addition to performing responsibilities as President and Chief Operating Officer, he has direct responsibility for credit granting and collections, information technology, human resources, distribution, service and training. From 1984 to 1995, Dr. Nylin held several executive management positions, including Deputy Chancellor and Executive Vice President of Finance and Operation at Lamar University in Beaumont, Texas. Dr. Nylin obtained his B.S. degree in mathematics from Lamar University, and holds both a masters and doctorate degree in computer sciences from Purdue University. He has also completed a post-graduate program at Harvard University. Dr. Nylin is 63 years old.

**Scott L. Thompson** has served as a director since June 2004. Mr. Thompson is recently retired from Group 1 Automotive where he played a major role in the founding and subsequent growth of that New York Stock Exchange listed and Fortune 500 company. He served as Executive Vice President, Chief Financial Officer and Treasurer of Group 1 from February 2002 until his retirement. From 1996 until February 2002, Mr. Thompson served as Senior Vice President, Chief Financial Officer and Treasurer of Group 1. Mr. Thompson has extensive experience in automotive retailing, investments, energy and professional sports and is a certified public accountant. Mr. Thompson is 47 years old.

**William T. Trawick** has served as a director since September 2003. Since August 2000, Mr. Trawick has served as Executive Director of NATM Buying Corporation where he oversees the administrative activities of the multi-billion dollar regional group purchasing program of which we are a member. He also functions as a consultant to our merchandising department on an ongoing basis. From September 1996 to July 1999, Mr. Trawick served as our Vice President of Merchandising and was responsible for all product purchasing, merchandising and store operations. Mr. Trawick is 59 years old.

**Theodore M. Wright** has served as a director since September 2003. Mr. Wright served as the President of Sonic Automotive, Inc., a New York Stock Exchange listed and Fortune 300 automotive retailer, from October 2002 until his retirement, and served as one of its directors since 1997. Previously Mr. Wright served as its chief financial officer from April 1997 to April 2003. From 1995 to 1997, Mr. Wright was a Senior Manager in Deloitte & Touche LLP's Columbia, South Carolina office. From 1994 to 1995, he was a Senior Manager in Deloitte & Touche LLP's National Office of Accounting Research and SEC Services Department. Mr. Wright received a B.A. from Davidson College. Mr. Wright is 43 years old.

These directors will serve one year terms which expire at our 2007 annual meeting of stockholders.

### **Independent Board Composition**

The board has determined that the following directors are independent as defined by NASD listing standards: Marvin D. Brailsford, Jon E.M. Jacoby, Bob L. Martin, William T. Trawick, Scott L. Thompson, and Theodore M. Wright. The independent directors of the board held executive sessions at each meeting of the board of directors during fiscal 2006.

### **Board Meetings**

During fiscal 2006, the board held four regularly scheduled meetings. Each person serving as a director during fiscal 2006 attended at least 75% of the aggregate board and committee meetings held during the period he served as director during fiscal 2006.

### **Policy Regarding Director Attendance at the Annual Meeting of Stockholders**

It is our policy that each member of the board of directors is encouraged to attend our annual meeting of stockholders. Each director serving at the time of last year's annual meeting attended our annual meeting of stockholders.

### **Committees of the Board**

#### ***Audit Committee***

The Audit Committee recommends the appointment of our independent auditors. It also approves audit reports and plans, accounting policies, audit fees and certain other expenses. In connection with the rules adopted by the SEC and NASD, we adopted a revised written charter for the Audit Committee, which is posted on our website at [www.conns.com](http://www.conns.com) under "Investor Relations". The Audit Committee reviews and reassesses the adequacy of the written charter on an annual basis.

Messrs. Wright, Brailsford and Thompson serve on the Audit Committee. The Audit Committee held four meetings in fiscal 2006, which were attended by all of the members and one telephonic meeting with full participation by all members. The board has determined that each of Mr. Wright and Mr. Thompson is an "audit committee financial expert" as defined by SEC rules. In addition, each of the members of the Audit Committee is "independent" as defined by the NASD listing standards and the Sarbanes-Oxley Act of 2002.

#### ***Compensation Committee***

The Compensation Committee determines executive officer compensation and administers our compensation and incentive plans. The Compensation Committee also evaluates the competitiveness of our compensation and the performance of our executive officers, including our Chief Executive Officer. In connection with the rules adopted by the SEC and NASD, we adopted a revised written charter for the Compensation Committee, which is posted on our website at [www.conns.com](http://www.conns.com) under "Investor Relations."

Messrs. Jacoby, Trawick, and Wright serve on the Compensation Committee. The Compensation Committee held two regular meetings, and one by written consent in lieu of a meeting, in fiscal 2006, which were attended by all the members. All members of the Compensation Committee are independent directors as defined by NASD regulations.

### **Nominating Policies**

In preparation of our initial public offering, we conducted a thorough process of selecting qualified directors for our board. All directors whose terms expire at this annual meeting, except Mr. Jacoby, Dr. Nylin, and Mr. Thompson, were appointed in September 2003 in preparation for that offering. Mr. Jacoby

was appointed to our board in April 2003, Mr. Thompson was appointed to our board in June 2004, and Dr. Nylin was appointed to our Board in March 2006. We do not currently have a standing nominating committee. Our board believes that at this time it would not be a prudent use of our board's resources to have a separate nominating committee and those resources are better utilized on our other committees and board functions. Thus, in accordance with Nasdaq rules, a majority of our independent directors will continue to recommend director nominees for the board's selection.

The goal of our board has been, and continues to be, to identify nominees for service on the board of directors who will bring a variety of perspectives and skills from their professional and business experience. In furtherance of this goal, our board has adopted nominating policies and procedures which are available on our website at [www.conns.com](http://www.conns.com) under "Investor Relations." The independent directors will consider candidates for nomination proposed by stockholders so long as they are made in accordance with the provisions of Section 2.14 of our Bylaws.

For the independent directors to consider candidates recommended by stockholders, Section 2.14 of our Bylaws requires that the stockholder provide written notice to our Secretary no later than the close of business on the ninetieth (90<sup>th</sup>) day nor earlier than the close of business on the one hundred twentieth (120<sup>th</sup>) day prior to the anniversary date of the proxy statement for the immediately preceding annual meeting of the stockholders. The notice to our Secretary must set forth (a) as to each person whom the stockholder proposes to nominate for election or re-election as a director, information relating to such person that is required to be disclosed in solicitations of proxies for election of directors, or is otherwise required, in each case pursuant to Regulation 14A under the Securities Exchange Act of 1934 (including such person's written consent to being named in the proxy statement as a nominee and to serve as a director if elected); (b) as to any other business that the stockholder proposes to bring before the meeting, a brief description of such business, the reasons for conducting such business at the meeting and any material interest in the business by the stockholder and the beneficial owner, if any, on whose behalf the proposal is made; and (c) as to the stockholder giving the notice and the beneficial owner, if any, on whose behalf the nomination or proposal is made (i) the name and address, as they appear on the company's books, of such stockholder and beneficial owner; and (ii) the class and number of shares of the company that are owned beneficially and held of record by such stockholder and such beneficial owner. Notwithstanding this procedure, the Board may, in its discretion, exclude from any proxy materials set to stockholders any matters that may properly be excluded under the Exchange Act, Securities and Exchange Commission rules or other applicable laws.

The independent directors believe that the minimum requirements for a person to be qualified to be a member of the board of directors, are that a person must (i) be an individual of the highest character and integrity and have an inquiring mind, vision, a willingness to ask hard questions and the ability to work well with others; (ii) be free of any conflict of interest that would violate any applicable law or regulation or interfere with the proper and reasonable performance of the responsibilities of a director; (iii) be willing and able to devote sufficient time to the affairs of the company and be diligent in fulfilling the responsibilities of a director and board committee member (including developing and maintaining sufficient knowledge of the company and its industry; reviewing and analyzing reports and other information important to the board and committee responsibilities; preparing for, attending and participating in board and committee meetings; and satisfying appropriate orientation and continuing education guidelines); and (iv) have the capacity and desire to represent the balanced, best interest of the stockholders as a whole and not primarily a special interest group or constituency. The independent directors evaluate whether certain individuals possess the foregoing qualities and recommends to the board for nomination candidates for election or re-election as directors at the annual meeting of stockholders, or if applicable, at a special meeting of stockholders. This process is the same regardless of whether the nominee is recommended by our board or one of our stockholders.

### **Compensation of Directors**

Through May 25, 2005, non-employee directors received an annual retainer of \$5,000. Additionally, non-employee directors received \$1,000 for each board meeting, and \$750 for each committee meeting attended on the same day as the board meeting and \$1,250 for each committee meeting attended on a different day than the board meeting. The non-employee directors were reimbursed for their expenses in attending such meetings. Commencing May 26, 2005 through the 2007 annual meeting, each non-employee director of the board in respect of his or her service on the board receive:

- an annual retainer of \$15,000 through the 2006 annual meeting; and \$25,000 through the 2007 annual meeting;
- \$2,500 for each board meeting attended;
- \$1,000 for each audit committee meeting attended by a member of the audit committee (excluding the chair of the audit committee) on the same day as a board meeting;
- \$1,500 for each audit committee meeting attended by the chair of the audit committee on the same day as a board meeting;
- \$2,500 for each audit committee meeting attended by a member of the audit committee (excluding the chair of the audit committee) on a day other than the day of the board meeting;
- \$3,500 for each audit committee meeting attended by the chair of the audit committee meeting on a day other than the day of the board meeting;
- \$500 per meeting for participation in a telephonic meeting of the board;
- \$750 for each compensation committee meeting attended by a member of the compensation committee on the same day as a board meeting;
- \$1,250 for each compensation committee meeting attended by a member of the compensation committee on a day other than the day of a board meeting.

In addition our non-employee directors (i) are allowed to participate in the Company's medical plan at the same contributories with all the benefits of full-time active employees, (ii) receive a merchandise discount in the same amount as the discount our employees receive; and (iii) are reimbursed for their expenses in attending board and committee meetings.

We adopted the 2003 Non-Employee Director Stock Option Plan in February 2003 in connection with our initial public offering. The plan is administered by the board of directors. Only non-employee directors are eligible grantees. Upon the closing of the initial public offering, we granted each of our then-current non-employee directors an option to purchase 40,000 shares of our common stock, and we have and will grant an option to purchase 40,000 shares of our common stock to any new board member. We will also grant our non-employee directors an option to purchase an additional 10,000 shares following each annual stockholders meeting on and after the fourth anniversary of each non-employee director's initial election or appointment to the board of directors. All options issued to non-employee directors vest equally over a three year period. The plan provides for 300,000 shares for issuance upon the exercise of options granted under the plan, subject to adjustment for capitalization changes. The exercise price of each option is equal to the fair market value of our common stock at the time the option is granted. The options have a term of up to ten years. Upon a change in control or sale of the company, optionees have special vesting and exercise rights. If the proposed amendment to the Non-Employee Director Stock Option Plan is approved by the shareholders, the plan will provide for 600,000 shares for issuance, and options granted on the fourth anniversary date of the date of a director's election to the board of directors and on each anniversary date thereafter, as required by the plan, will vest on the first anniversary date of the date of each grant of such options.

### **Indemnification Arrangements**

As permitted by the Delaware General Corporation Law, we have adopted provisions in our certificate of incorporation and bylaws that provide for the indemnification of our directors and officers to the fullest extent permitted by applicable law. These provisions, among other things, indemnify each of our directors and officers for certain expenses, including judgments, fines and amounts paid in settling or otherwise disposing of actions or threatened actions, incurred by reason of the fact that such person was a director or officer of Conn's or of any other corporation which such person served in any capacity at the request of Conn's.

In addition, we have entered into indemnification agreements with each of our directors pursuant to which we will indemnify them against judgments, claims, damages, losses and expenses incurred as a result of the fact that any director, in his capacity as a director, is made or threatened to be made a party to any suit or proceeding. The indemnification agreements also provide for the advancement of certain expenses (such as attorney's fees, witness fees, damages, judgments, fines and settlement costs) to our directors in connection with any such suit or proceeding.

We maintain a directors' and officers' liability insurance policy to insure our directors and officers against certain losses resulting from acts committed by them in their capacities as our directors and officers, including liabilities arising under the Securities Act of 1933.

**Stockholder Communications with the Board:**

We have adopted a policy that allows stockholders to communicate directly with the board of directors. Stockholders may contact the board or any committee of the board by any one of the following methods:

By telephone:	By mail:	By e-mail:
(409) 832-1696 Ext. 3218	Board of Directors 3295 College Street Beaumont, Texas 77701	Conns1890ff@aol.com

All communications submitted under this policy will be compiled by the Compliance Officer of the company and submitted to the board or the requisite board committee on a periodic basis. Complaints or concerns relating to accounting, internal accounting controls or auditing matters will be referred to the Audit Committee under the policy adopted by the Audit Committee. This policy and procedure is posted on our website at [www.conns.com](http://www.conns.com) under "Investor Relations".

## **AUDIT COMMITTEE REPORT**

### **The Committee**

Our board of directors established the Audit Committee to recommend the appointment of our independent auditors and to oversee the company's (i) financial reporting process; (ii) internal audits, internal control policies and procedures implementation and compliance with Sarbanes-Oxley Section 404 requirements, and authorities; and (iii) financial, tax, and risk management policies. The Audit Committee is composed of three members and operates under a written charter, a copy of which is published on our website at [www.conns.com](http://www.conns.com) under "Investor Relations." The Audit Committee has prepared the following report on its activities with respect to the company's financial statements for the fiscal year ended January 31, 2006.

### **Review and Discussion**

Management is responsible for the Company's financial reporting process including its system of internal controls, and for the preparation of Conn's consolidated financial statements in accordance with generally accepted accounting principles. Ernst & Young LLP, the company's independent auditors, is responsible for auditing those financial statements for attesting to Management's Report on Internal Control over Financial Reporting, and for assessing the effectiveness of internal control over financial reporting. It is the Audit Committee's responsibility to monitor and review these processes. The members of the Audit Committee are not employees of the Company and do not represent themselves to be or to serve as, accountants or auditors by profession or experts in the field of accounting or auditing.

In connection with the preparation of the Company's audited financial statements for the fiscal year ended January 31, 2006, the Audit Committee:

- reviewed and discussed the Company's annual report on Form 10-K, including the audited consolidated financial statements of the Company and Management's Report on Internal Control over Financial Reporting for the year ended January 31, 2006 with management;
- discussed with Ernst & Young the matters required to be discussed by Statement on Auditing Standards No. 61;
- received the written disclosures and the letter from Ernst & Young required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees), and discussed with Ernst & Young its independence from Conn's, including whether Ernst & Young's provision of non-audit services to the company is compatible with the auditors' independence.

The Audit Committee meets with the company's independent auditors to discuss the results of their examinations, their evaluations of the company's internal controls and the overall quality of the company's financial reporting. The Audit Committee held five meetings, including one telephonic meeting during the fiscal year ended January 31, 2006.

### **Recommendation**

Based on the review and discussion referred to above, the Audit Committee recommended to the board of directors that the audited financial statements be included in our Annual Report on Form 10-K for the fiscal year ended January 31, 2006, for filing with the Securities and Exchange Commission.

### **AUDIT COMMITTEE:**

Theodore M. Wright, Chairman  
Marvin D. Brailsford  
Scott L. Thompson

## **COMPENSATION COMMITTEE REPORT**

### **The Committee**

The Compensation Committee determines the compensation of the company's Chief Executive Officer and other executive officers of the company, evaluates the compensation plans, policies and programs applicable to executive officers of the company and makes recommendations to the board concerning such plans, policies and programs, advises the board regarding compensation plans, policies and programs applicable to non-employee directors for their services as a director and administers the company's stock option, stock purchase and other plans, which under their terms are to be administered by the Compensation Committee.

### **Overall Philosophy and Objectives**

We have developed a compensation program for executives and key employees designed to: (i) reward performance that increases the value of our common stock; (ii) attract, retain and motivate executives and key employees with competitive compensation opportunities; (iii) build and encourage ownership of our shares; and (iv) address the concerns of our stockholders, employees, the financial community and the general public.

To meet these objectives, we reviewed competitive compensation data and implemented the base salary and incentive programs discussed below.

### **Executive Compensation**

The available forms of executive compensation include base salary, cash bonus awards and incentive stock options. Our performance is a key consideration in determining executive compensation. However, our compensation policy recognizes that stock price performance is only one measure of performance and, given industry business conditions and our long-term strategic direction and goals, it may not necessarily be the best current measure of executive performance. Therefore, our compensation policy also gives consideration to the achievement of specified business objectives when determining executive officer compensation. The Compensation Committee, in certain cases, offers employees and executive officers equity compensation in addition to salary in keeping with our overall compensation philosophy, which attempts to place equity in the hands of our employees in an effort to further instill stockholder considerations and values in the actions of all our employees and executive officers.

Compensation paid to executive officers is based upon a company-wide compensation structure that emphasizes incentive bonus compensation based upon individual and company performance and is consistent for each position relative to its authority and responsibility. Stock option awards in fiscal 2006 were used to reward certain officers and to retain them through the potential of capital gains and equity buildup in Conn's. The number of stock options granted is determined by the subjective evaluation of the officer's ability to influence our long-term growth and profitability. Stock options granted to our senior management have been granted only pursuant to our Amended and Restated 2003 Incentive Stock Option Plan. The board believes the award of options represents an effective incentive to create value for our stockholders.

### **CEO Compensation**

The Compensation Committee established a base salary for Mr. Thomas Frank of \$480,000 for fiscal year 2006. The Compensation Committee also awarded Mr. Thomas Frank a bonus of \$900,000 for services rendered in fiscal year 2006. For the 2007 fiscal year, the Compensation Committee established a base salary for Mr. Thomas Frank of \$480,000. The Compensation Committee deemed the 2006 bonus and the salary level for 2006 to be generally commensurate with the Chief Executive Officer's position at comparable publicly owned companies and in recognition of the responsibilities associated with our growth, performance and public company status. In determining Mr. Thomas Frank's salary and bonus, the Compensation Committee considered his industry experience, past performance and other subjective factors.

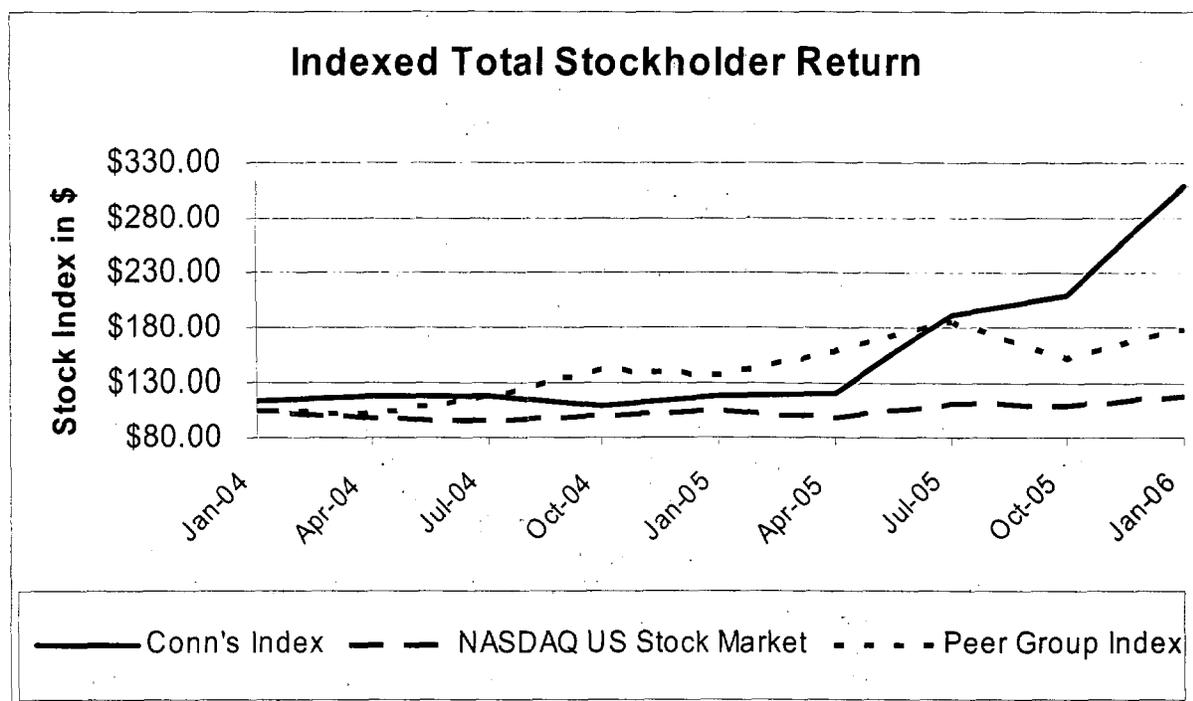
The Compensation Committee believes that the Chief Executive Officer's 2006 and 2007 compensation levels were and are justified by Conn's financial progress and performance against the goals set by the Compensation Committee.

**COMPENSATION COMMITTEE:**

Jon E.M. Jacoby, Chairman  
William T. Trawick  
Theodore M. Wright

## PERFORMANCE GRAPH

The following graph provides a comparison of the cumulative total stockholder return on our common stock against the Nasdaq U.S. Stock Market Index and the average of a peer group index comprised of five publicly traded consumer electronic and/or appliance retailers<sup>(1)</sup> since our initial public offering on November 24, 2003. Since we have not been publicly traded for five years, we have selected November 24, 2003, the date our initial public offering, and the end of each of our fiscal quarters between November 24, 2003 and January 31, 2006 (the last trading day of our fiscal year) for comparison purposes. The graph reflects the value of a \$100 investment as of November 24, 2003 in either our stock or the indices presented at the dates of measurement, including reinvestment of dividends. The corresponding index values and common stock price values are summarized in the table below by measurement date.



Trade Date	Conn's Index	NASDAQ US Stock Market Index	Peer Group Stock Index <sup>1</sup>	Conn's Closing Stock Price
November 24, 2003	\$100.00	\$100.00	\$100.00	\$ 14.00
January 31, 2004	114.29	106.11	105.51	16.00
April 30, 2004	118.57	98.61	102.22	16.60
July 31, 2004	119.36	96.93	117.86	16.71
October 31, 2004	109.43	101.43	140.87	15.32
January 31, 2005	118.21	105.92	137.22	16.55
April 30, 2005	121.64	98.69	157.15	17.03
July 31, 2005	191.36	112.21	184.58	26.79
October 31, 2005	209.07	108.89	150.92	29.27
January 31, 2006	310.57	118.42	178.18	43.48

<sup>1</sup> The peer group index consists of the simple average of the indices of Sears, Roebuck & Co., Best Buy Co., Inc., Circuit City Stores, Inc., Rex Stores Corp. and Tweeter Home Entertainment Group, Inc.

## EXECUTIVE OFFICERS

### Biographical Information

The board appoints our executive officers at the first board meeting following our annual meeting of stockholders and updates the executive officer positions as necessary. Our executive officers serve at the discretion of the board and until their successors are elected and qualified or until the earlier of their death, resignation or removal.

The following sets forth certain biographical information regarding our executive officers, including service with Conn Appliances, Inc., our predecessor company:

<u>Name</u>	<u>Age</u>	<u>Positions</u>	<u>Years of Service with Conn's</u>
Thomas J. Frank, Sr.	66	Chairman of the Board and Chief Executive Officer	46
William C. Nylin, Jr.	63	Executive Vice Chairman of the Board and Chief Operating Officer	13
David L. Rogers	57	Chief Financial Officer	9
Timothy L. Frank	38	President	10
David R. Atnip	58	Senior Vice President and Treasurer	13
Walter M. Broussard	46	Senior Vice President – Sales	20
Robert B. Lee, Jr.	59	Senior Vice President – Services and Logistics	6
David W. Trahan	45	Senior Vice President – Retail	18
Reymundo de la Fuente, Jr.	45	Senior Vice President – Credit	7

**Thomas J. Frank, Sr.** was appointed as our Chairman of the Board and Chief Executive Officer in 1994. He has been employed by us for 46 years, has been a member of our board of directors since 1980 and has held every key management position within the organization, including responsibilities for distribution, service, credit, information technology, accounting and general operations. Mr. Frank holds a B.A. degree in industrial arts from Sam Houston State University and attended graduate courses at Texas A&M University. Mr. Frank completed the SCMP course at Harvard University. Mr. Frank is the father of Timothy L. Frank, our Senior Vice President-Retail.

**William C. Nylin, Jr.** On March 28, 2006, Dr. Nylin was appointed to our board of directors as its Executive Vice Chairman. He has served as our Chief Operating Officer since 1995, and from 1995 until April 1, 2006, he also served as our President. He became a member of our board of directors in 1993 and served in that capacity until September 2003, and was appointed to our board of directors on March 28, 2006 by our board. In addition to performing responsibilities as Chief Operating Officer, he has direct responsibility for credit granting and collections, information technology, human resources, distribution, service and training. From 1984 to 1995, Dr. Nylin held several executive management positions, including Deputy Chancellor and Executive Vice President of Finance and Operations at Lamar University. Dr. Nylin obtained his B.S. degree in mathematics from Lamar University and holds both a masters degree and a doctorate degree in computer sciences from Purdue University. He has also completed a post-graduate program at Harvard University.

**David L. Rogers** was appointed as our Chief Financial Officer Designate, effective September 1, 2004 and our Chief Financial Officer effective January 31, 2005. Mr. Rogers joined us in October 1996 and served as our Legal Manager until August 1997. He has served as our Controller from September 1997 until September 1, 2004. Prior to his joining our Company, Mr. Rogers served in various accounting positions during a twenty-year career with a Fortune 500 public utility. Mr. Rogers obtained his B.B.A. in accounting from Lamar University in December, 1974.

**Timothy L. Frank** was elected President of our Company by our board of directors on March 28, 2006, effective April 1, 2006. Mr. Frank has previously served as our Senior Vice President – Retail from May, 2005. He joined us in September 1995 and has served in various roles throughout our Company, including Director of Advertising, Director of Credit, Director of Legal Collections, Director of Direct Marketing, and as Vice President of Special Projects. Prior to joining our Company, Mr. Frank served in various marketing positions with a nationally known marketing consulting company. Mr. Frank holds a BS

in Liberal Arts from Texas A & M University and an MBA in Marketing from the University of North Texas. Mr. Frank has also completed a post-graduate program at Harvard University. Mr. Frank is the son of Thomas J. Frank, Sr., our Chairman and Chief Executive Officer.

**David R. Atnip** has served as our Senior Vice President since October 2001 and as our Treasurer since 1997. He joined us in 1992 and served as Chief Financial Officer from 1994 to 1997 and as our Secretary from 1997 to 2005. In 1995, he joined our board of directors and served in that capacity until September 2003. Mr. Atnip holds a B.B.A. in accounting from The University of Texas at Arlington and has over 20 years of financial experience in the savings and loan industry.

**Walter M. Broussard** has served as our Senior Vice President - Sales since 2005, and previously served as our Senior Vice President - Store Operations from October 2001. Mr. Broussard has served us in numerous retail capacities since 1985, including working on the sales floor as a sales consultant, store manager and district manager. He has over 25 years of retail sales experience. He attended Lamar University and has completed special study programs at Harvard University, Rice University and the University of Notre Dame.

**Robert B. Lee, Jr.** has served as our Senior Vice President - Service and Logistics since April, 2005, after serving as our Vice President - Advertising, and was our Senior Vice President - Advertising from October 2001 and Vice President - Advertising from January, 1999 until October 2001. His responsibilities include managing our Service Division and Distribution Division. The Service Division is responsible for providing factory authorized service from the Company's five regional service centers for the majority of the products that we sell. The Distribution Division consists of warehousing, transportation and delivery operations from our five regional warehouse and two cross-dock facilities. He also chairs our site selection committee and manages our Facility Maintenance department. From 1990 until 1998, he was a partner in Ann Lee & Associates, a Beaumont-based advertising agency and public relations firm where he served as Chief Operating Officer. Mr. Lee obtained a B.B.A. from The University of Texas at Austin and completed a post-graduate program at the University of Notre Dame.

**David W. Trahan** was elected Senior Vice President - Retail by our Board of Directors on March 28, 2006, effective April 1, 2006. He has previously served as our Senior Vice President - Merchandising from October 2001. He has been employed by us since 1986 in various capacities, including sales, store operations and merchandising. He has been directly responsible for our merchandising and product purchasing functions, as well as product display and pricing operations, for the last four years. Mr. Trahan has completed special study programs at Harvard University, Rice University and Lamar University.

**Reymundo de la Fuente, Jr.** has served as our Senior Vice President - Credit since October 2001 and also serves as President of our credit subsidiary. Since joining us in 1998, he has served in positions that involve direct responsibility for credit underwriting, customer service inbound operations, collections, recovery of charge-offs and legal activities. Mr. de la Fuente has worked in the credit receivables industry since 1986 with national credit organizations. His responsibilities included the strategic direction and development of large credit portfolios. Mr. de la Fuente obtained his B.B.A. in finance from The University of Texas at San Antonio and holds an M.B.A. from Our Lady of the Lake in San Antonio.

#### **Code of Ethics**

Our board has adopted a code of business conduct and ethics for our employees, a code of ethics for our chief executive officer and senior financial professionals and a code of business conduct and ethics for our board of directors. A copy of these codes are published on our website at [www.conns.com](http://www.conns.com) under "Investor Relations." We intend to make all required disclosures concerning any amendments to, or waivers from, these codes on our website.

## Executive Compensation

### Summary Compensation Table

The following table sets forth the total compensation paid or accrued by us for the fiscal years ended January 31, 2004, 2005 and 2006 on behalf of each of our named executive officers.

Name and Position	Fiscal Year	Annual Compensation		Long-Term Compensation	All Other Compensation
		Salary	Bonus	Securities Underlying Options (No. of Shares)	Company Contributions to 401(k) Plan
Thomas J. Frank, Sr.	2004	\$ 465,000	\$ 900,000	56,500	\$ 11,100 <sup>(1)</sup>
Chairman of the Board	2005	480,000	900,000	35,000	8,200
and Chief Executive Officer	2006	480,000	900,000	25,000	8,400
William C. Nylin, Jr.	2004	290,000	300,000	56,500	9,804 <sup>(1)</sup>
Executive Vice Chairman	2005	314,167	455,000	35,000	8,200
of the Board and Chief	2006	360,000	700,000	15,000	8,400
Operating Officer					
David W. Trahan	2004	180,000	180,000	8,000	7,284
Senior Vice President	2005	182,000	225,000	10,000	8,200
-Retail	2006	204,000	400,000	15,000	8,400
Reymundo de la Fuente	2004	120,000	120,000	8,000	7,200
Senior Vice President	2005	138,333	165,000	10,000	8,200
-Credit	2006	162,500	320,000	15,000	8,400
Timothy L. Frank	2004	120,000	120,000	8,000	7,600
President	2005	122,000	155,000	10,000	8,200
	2006	160,500	320,000	15,000	7,040

<sup>(1)</sup> Includes \$1,500 in fees paid to these officers for service as a director during fiscal 2004.

### Employment Agreements

We have employment agreements with Thomas J. Frank, Sr., our Chairman of the Board and Chief Executive Officer, William C. Nylin, Jr., our Executive Vice Chairman of the Board and Chief Operating Officer, David L. Rogers, our Chief Financial Officer and David R. Atnip, our Senior Vice President and Secretary/Treasurer. Under the terms of these employment agreements, each of our executive officers is entitled to payment of an annual salary plus a bonus based upon attainment of performance goals determined by our Compensation Committee, to participate in our employee benefit plans and to receive options to purchase shares of our common stock. In the event that we terminate the executive officer's employment other than for cause or we do not renew the employment agreement when it expires, we are obligated to pay the executive officer severance in an amount equal to the executive officer's annual base salary. All of our executive officers' employment agreements with us contain confidentiality and other customary provisions.

### Option Grants in Last Fiscal Year

Name	Number of Securities Underlying Options Granted	% of Total Granted in Fiscal 2003	Exercise Price	Expiration Date	Potential Realizable Value at Assumed Annual Stock Price Appreciation for Option Term	
					5%	10%
Thomas J. Frank, Sr.	25,000	7.3%	\$33.88	11/30/2015	\$532,674	\$1,349,900
William C. Nylin, Jr.	15,000	4.4%	\$33.88	11/30/2015	319,604	809,940
David W. Trahan	15,000	4.4%	\$33.88	11/30/2015	319,604	809,940
Reymundo de la Fuente	15,000	4.4%	\$33.88	11/30/2015	319,604	809,940
Timothy L. Frank	15,000	4.4%	\$33.88	11/30/2015	319,604	809,940

## Aggregated Option Exercises in Last Fiscal Year and Fiscal Year-End Option Values

The following table provides certain information with respect to options to purchase common stock held by our named executive officers as of January 31, 2006.

Name	Shares	Value	Number of Securities		Value of Unexercised	
	Acquired		Underlying Unexercised		In-the-Money Options	
	on	Realized	Options at Fiscal Year End		at Fiscal Year End	
	Exercise		Exercisable	Unexercisable	Exercisable	Unexercisable
Thomas J. Frank, Sr.	—	—	29,600	86,900	\$846,498	\$1,960,372
William C. Nylin, Jr.	—	—	52,056	82,514	1,638,521	2,062,378
David W. Trahan	—	—	5,200	27,800	145,836	491,504
Reymundo de la Fuente	—	—	94,800	36,200	3,306,028	787,772
Timothy L. Frank	44,912	\$1,584,046	5,200	39,028	145,836	887,516

## Equity Incentive Plans

### *Amended and Restated 2003 Incentive Stock Option Plan*

In February 2003, we adopted our Amended and Restated 2003 Incentive Stock Option Plan, and amended the Plan in June 2004. The plan is administered by the Compensation Committee of our board of directors. Our employees and employees of our subsidiaries, subject to certain exclusions, are eligible to participate in the plan. Option grants are made within the discretion of the Compensation Committee. Options may be granted for such terms as the Compensation Committee may determine, but not for terms greater than ten years from the date of grant. The maximum number of shares of our common stock that may be issued under this plan is 2,559,767 shares, subject to adjustment, and 3,859,767 shares subject to adjustment assuming Proposal Two is adopted. All options issued vest equally over either a three-year term or a five-year term. At January 31, 2006, there were options to purchase 1,625,556 shares of our common stock issued and outstanding under the plan.

### *Employee Stock Purchase Plan*

In February 2003, we adopted our Employee Stock Purchase Plan. The plan is administered by the Compensation Committee of our board of directors. Our employees and employees of our subsidiaries, subject to certain exclusions, are eligible to participate in the plan. Eligible employees are able to purchase shares of our common stock without brokerage commissions and at a discount from market prices. The maximum number of shares of our common stock that may be issued under this plan is 1,267,085 shares, subject to adjustment.

### *2003 Non-Employee Director Stock Option Plan*

We also have the 2003 Non-Employee Director Stock Option Plan, which we adopted in February 2003 and is discussed on page 10. The maximum number of shares of our common stock that may be issued under this plan is 300,000 shares, subject to adjustment, and 600,000 shares subject to adjustment assuming Proposal Two is adopted. All options issued to a director when he or she becomes a director currently vest equally over a three-year term. At January 31, 2006, there were options to purchase 258,000 shares of our common stock issued and outstanding under the plan.

The following table provides information regarding the number of shares of our common stock that may be issued on exercise of outstanding stock options and warrants under our existing equity compensation plans as of January 31, 2006. These plans are as follows:

- the Amended and Restated 2003 Incentive Stock Option Plan;
- the Non-Employee Director Stock Option Plan; and
- the Employee Stock Purchase Program.

	(A)	(B)	(C)
Plan Category	Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (A))
Equity Compensation Plans Approved by Stockholders	1,883,556 (1)	\$16.05	472,949 (1)
Equity Compensation Plans Not Approved by Stockholders	-	-	-
<b>Total</b>	<b>1,883,556</b>	<b>\$16.05</b>	<b>472,949</b>

(1) Includes 258,000 outstanding options and 20,000 options available for future issue applicable to the Non-Employee Director Stock Option Plan.

### STOCK OWNERSHIP OF DIRECTORS, EXECUTIVE OFFICERS AND PRINCIPAL STOCKHOLDERS

The following table sets forth information regarding the beneficial ownership of our common stock for each person who is known by us to be the beneficial owner of more than 5% of our voting securities, for each director and named executive officer, and for all directors and executive officers as a group. Unless otherwise indicated in the footnotes, each person named below has sole voting and investment power over the shares indicated. For purposes of this table, a person is deemed to be the "beneficial owner" of the number of shares of common stock that such person has the right to acquire within 60 days of April 14, 2006 through the exercise of any option, warrant or right, through the conversion of any security, through the power to revoke a trust, discretionary account, or similar arrangement, or through the automatic termination of a trust, discretionary account or similar arrangement.

Name	Common Stock Owned	Percent of Common Stock Owned
Conn's Voting Trust (1)	11,501,348	48.66%
Stephens Group, Inc. (2)	1,005,772	4.26%
Stephens Inc.	328,902	1.39%
Warren A. Stephens	3,693,012 (3)	15.63%
W.R. Stephens, Jr.	3,282,253 (4)	13.89%
Elizabeth Stephens Campbell	3,024,724 (5)	12.80%
Pamela Dianne Stephens Trust One	1,682,862	7.12%
Jackson T. Stephens Trust No. One	208,105	0.88%
Bess C. Stephens	2,093,741 (6)	8.86%
Jon E.M. Jacoby	2,756,278 (7)	11.66%
Douglas H. Martin	342,170 (8)	1.45%
All other Stephens Affiliates	378,600	1.60%
GAM London Ltd	1,386,442	5.87%
Thomas J. Frank, Sr.	967,879 (9)	4.10%
William C. Nylin, Jr.	282,941 (10)	1.20%
David W. Trahan	169,730 (11)	0.72%
Rey de la Fuente	130,800 (12)	0.55%
Timothy L. Frank	96,572 (13)	0.41%
Marvin D. Brailsford	26,667 (14)	0.11%
Bob L. Martin	26,667 (15)	0.11%
William T. Trawick	26,667 (16)	0.11%
Theodore M. Wright	9,667 (17)	0.04%
Scott L. Thompson	1,546 (18)	-
Directors and officers (16 persons)	4,837,584 (19)	20.47%

<sup>(1)</sup> These shares have been contributed to a voting trust agreement and are held and voted by an independent third party as voting trustee. The voting trust will vote the shares held in the voting trust in the same proportion as votes cast "for" or "against" any proposals by all other stockholders. The voting trust agreement imposes substantial limitations on the sale or other disposition of the shares subject to the voting trust. The voting trust agreement will expire in November 2013 or such earlier time as Stephens Inc. ceases to be an affiliate of ours or a market maker of our common stock.

<sup>(2)</sup> The principal stockholders of Stephens Group, Inc. are the Jackson T. Stephens Trust No. One UID 1/4/88 and the Bess C. Stephens Trust UID 1/4/85. Warren A. Stephens is a director and an officer of Stephens Group, Inc. and its subsidiary Stephens Inc. W.R. Stephens, Jr. is a director and an officer of Stephens Group, Inc. and Stephens Inc. Mr. Jacoby is a director of Stephens Group, Inc. Mr. Martin is a director and an officer of Stephens Group, Inc. Jackson T. Stephens is Chairman of the Board of Directors and Bess C. Stephens is a director of Stephens Group, Inc. The address of each of the above named persons is c/o Stephens Group, Inc., 111 Center Street, Little Rock, Arkansas 72201.

<sup>(3)</sup> Includes 1,906,549 shares owned by Warren A. Stephens Trust, 4,356 shares owned by Warren Miles Amerine Stephens Trust, 4,356 shares owned by John Calhoun Stephens Trust and 4,356 shares owned by Laura Whitaker Stephens Trust, which have been contributed to the voting trust and as to which Mr. Stephens has no power to vote and sole power of disposition; 665,100 shares owned by Grandchild's Trust #2 and 208,105 shares owned by Jackson T. Stephens Trust No. One, which have been contributed to the voting trust and as to which Mr. Stephens has no power to vote and shared power of disposition; 739,100 shares owned by Harriet C. Stephens Trust, which have been contributed to the voting trust; 4,245 shares owned by Stephens Investment Partners III LLC, 120,723 shares owned by Stephens Investment Partners 2000 LLC and 36,122 shares owned by Stephens Investment Partners 2001 LLC, as to which Mr. Stephens, as co-manager, has shared power to vote and shared power of disposition. Does not include shares owned by Stephens Group, Inc. or any of its affiliates, except as mentioned in this footnote.

<sup>(4)</sup> Includes 1,162,530 shares owned by W.R. Stephens, Jr. Revocable Trust, which have been contributed to the voting trust and as to which Mr. Stephens, as trustee, has no power to vote and sole power of disposition; 202,774 shares owned by W.R. Stephens, Jr. Children's Trust, 30,489 shares held by W.R. Stephens III Trust, 30,489 shares held by Arden Jewell Stephens Trust and 1,682,862 shares held by Pamela D. Stephens Trust One, which have been contributed to the voting trust and as to which Mr. Stephens, as a co-trustee or otherwise, has no power to vote and shared power of disposition; 12,019 shares owned by Carol Stephens which have been contributed to the voting trust; 4,245 shares owned by Stephens Investment Partners III LLC, 120,723 shares owned by Stephens Investment Partners 2000 LLC and 36,122 shares owned by Stephens Investment Partners 2001 LLC, as to which Mr. Stephens, as co-manager, has shared power to vote and shared power of disposition. Does not include shares owned by Stephens Group, Inc. or any of its affiliates, except as mentioned in this footnote.

<sup>(5)</sup> Includes 1,091,531 shares owned by Elizabeth S. Campbell Revocable Trust, which have been contributed to the voting trust and as to which Ms. Campbell, as trustee, has no power to vote and sole power of disposition; 1,682,862 shares owned by Pamela D. Stephens Trust One and 250,331 shares owned by Francine, Inc., which have been contributed to the voting trust and as to which Ms. Campbell, as a co-trustee or otherwise, has no power to vote and shared power of disposition.

<sup>(6)</sup> Includes 202,774 shares owned by W.R. Stephens, Jr. Children's Trust, 208,105 shares owned by Bess C. Stephens Trust and 1,682,862 shares owned by Pamela D. Stephens Trust One, which have been contributed to the voting trust and as to which Ms. Stephens, as a co-trustee, has no power to vote and shared power of disposition.

<sup>(7)</sup> Includes 570,280 shares owned by Mr. Jacoby, 168,498 shares owned by Warren A. Stephens Grantor Trust, 918,123 shares owned by Warren & Harriet Stephens Children's Trust, 51,282 shares owned by Warren Miles Amerine Stephens 95 Trust, 51,282 shares owned by John Calhoun Stephens 95 Trust and 51,282 shares owned by Laura Whitaker Stephens 95 Trust, which have been contributed to the voting trust and as to which Mr. Jacoby, as sole trustee or otherwise, has no power to vote and sole power of disposition; 665,100 shares owned by Grandchild's Trust #2 and 208,105 shares owned by Jackson T. Stephens Trust No. One, which have been contributed to the voting trust and as to which Mr. Jacoby, as a co-trustee, has no power to vote and shared power of disposition; and 42,857 shares owned by Smiley Holdings, LLC, as to which Mr. Jacoby, as a manager, has sole power to vote and sole power of disposition; 2,803 shares owned by Mr. Jacoby which have not been contributed to the voting trust; and 26,666 shares which Mr. Jacoby has the right to receive upon the exercise of options exercisable on or within 60 days after April 15, 2006. Does not include shares owned by Stephens Group, Inc. or any of its affiliates, except as mentioned in this footnote.

<sup>(8)</sup> Includes 154,414 shares owned by Mr. Martin, which have been contributed to the voting trust and as to which Mr. Martin has no voting power and sole dispositive power; 4,245 shares owned by Stephens Investment Partners III LLC, 120,723 shares owned by Stephens Investment Partners 2000 LLC and 36,122 shares owned by Stephens Investment Partners 2001 LLC, as to which Mr. Martin, as co-manager, has shared power to vote and shared power of disposition; and 26,666 shares which Mr. Martin has the right to receive upon the exercise of options exercisable on or within 60 days after April 15, 2006. Does not include shares owned by Stephens Group, Inc. or any of its affiliates.

(9) Includes 338,279 shares owned by a trust over which Mr. Frank is the trustee and exercises sole voting power and sole dispositive power but over which Mr. Frank has no pecuniary interest and for which Mr. Frank disclaims beneficial ownership. Also includes options to purchase 29,600 shares of common stock.

(10) Includes options to purchase 52,056 shares of common stock.

(11) Includes options to purchase 5,200 shares of common stock.

(12) Includes options to purchase 94,800 shares of common stock.

(13) Includes options to purchase 5,000 shares of common stock.

(14) Includes options to purchase 26,667 shares of common stock.

(15) Includes options to purchase 26,667 shares of common stock.

(16) Includes options to purchase 26,667 shares of common stock.

(17) Includes options to purchase 9,667 shares of common stock.

(18) Includes options to purchase 1,546 shares of common stock.

(19) Includes options to purchase 506,591 shares of common stock.

## CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

### Lease Arrangement

Since 1996, we have leased one of our Houston, Texas store locations containing approximately 19,150 square feet from Thomas J. Frank, Sr., our Chairman of the Board and Chief Executive Officer. The lease provides for base monthly rental payments of \$17,235 plus escrow for taxes, insurance and common area maintenance expenses, which escalate annually, per month through January 31, 2011. We also have an option to renew the lease for two additional five-year terms. Mr. Frank received total payments under this lease of \$281,000 in each of fiscal years 2004, 2005, and 2006. Based on current market lease rates for comparable retail space in the area, we believe that the terms of this lease were at or better than fair market value at the date of the lease commencement.

### Independent Contractor

William T. Trawick has served as a member of our board of directors since September 2003 and served as an advisory director of Conn Appliances, Inc., our predecessor company, since August 1999. In addition to the fees paid to Mr. Trawick in his capacity as a director, we paid him consulting fees in the amount of \$58,000 in fiscal 2004, \$48,000 in fiscal 2005, and \$48,000 in fiscal 2006. Mr. Trawick is also the President and Executive Director of NATM Buying Corporation, a national buying group representing nine regional retailers, including us, in the appliance and electronics industry. NATM coordinates the buying and merchandising strategies for its member retailers. We recorded expenses of cash payments to NATM for membership dues of \$83,000 in fiscal years 2004, 2005, and 2006.

### Indirect Ownership in Service Provider

During fiscal year 2006, we engaged the services of Direct Marketing Solutions, Inc., or DMS, for a substantial portion of our direct mailing advertising. Direct Marketing Solutions, Inc. is partially owned by the Stephens Group Inc., members of the Stephens family, Jon E.M. Jacoby and Doug Martin. Thomas J. Frank, our Chief Executive Officer and the Chairman of our board of directors owned approximately 0.7% of DMS until July, 2005, at which time he divested his ownership. The Stephens Group Inc. and the members of the Stephens family are significant shareholders of our company, and Messrs. Jacoby and Martin are members of our Board of Directors. The fees we paid to DMS during fiscal 2005 and 2006 amounted to approximately \$1.8 million and \$4.1 million, respectively. When DMS was initially engaged to perform direct marketing services for us, a competitive analysis was performed from submissions by various marketing groups, with DMS presenting the low price point in these analyses. During fiscal 2006, additional competitive analyses have been performed which continually support that DMS offers us the lowest cost for this service. We will, at least annually, seek competitive bids for the services performed by DMS.

## SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Exchange Act requires that our directors, executive officers and other persons who own more than 10% of our outstanding common stock file initial reports of ownership and reports of changes in ownership of our common stock with the SEC. Officers, directors and other stockholders who own more than 10% of our outstanding common stock are required by the SEC to furnish us with copies of all Section 16(a) reports they file.

To our knowledge, based on a review of reports and information furnished to us by those persons who were directors, executive officers and/or the beneficial holders of 10% or more of our common stock at any time during the fiscal year ended January 31, 2006 and upon representations from such persons, we believe that all stock ownership reports required to be filed under section 16(a) by such reporting persons during the fiscal year ended January 31, 2006 were timely made.

## INDEPENDENT PUBLIC ACCOUNTANTS

Ernst & Young LLP served as our independent public accountants for the fiscal year ended January 31, 2006. The Audit Committee has appointed Ernst & Young as our independent public accountants for the fiscal year ending January 31, 2006. Representatives of Ernst & Young will attend the 2006 annual meeting of stockholders and will be available to respond to appropriate questions that may be asked by stockholders. These representatives will also have an opportunity to make a statement at the meeting if they desire to do so.

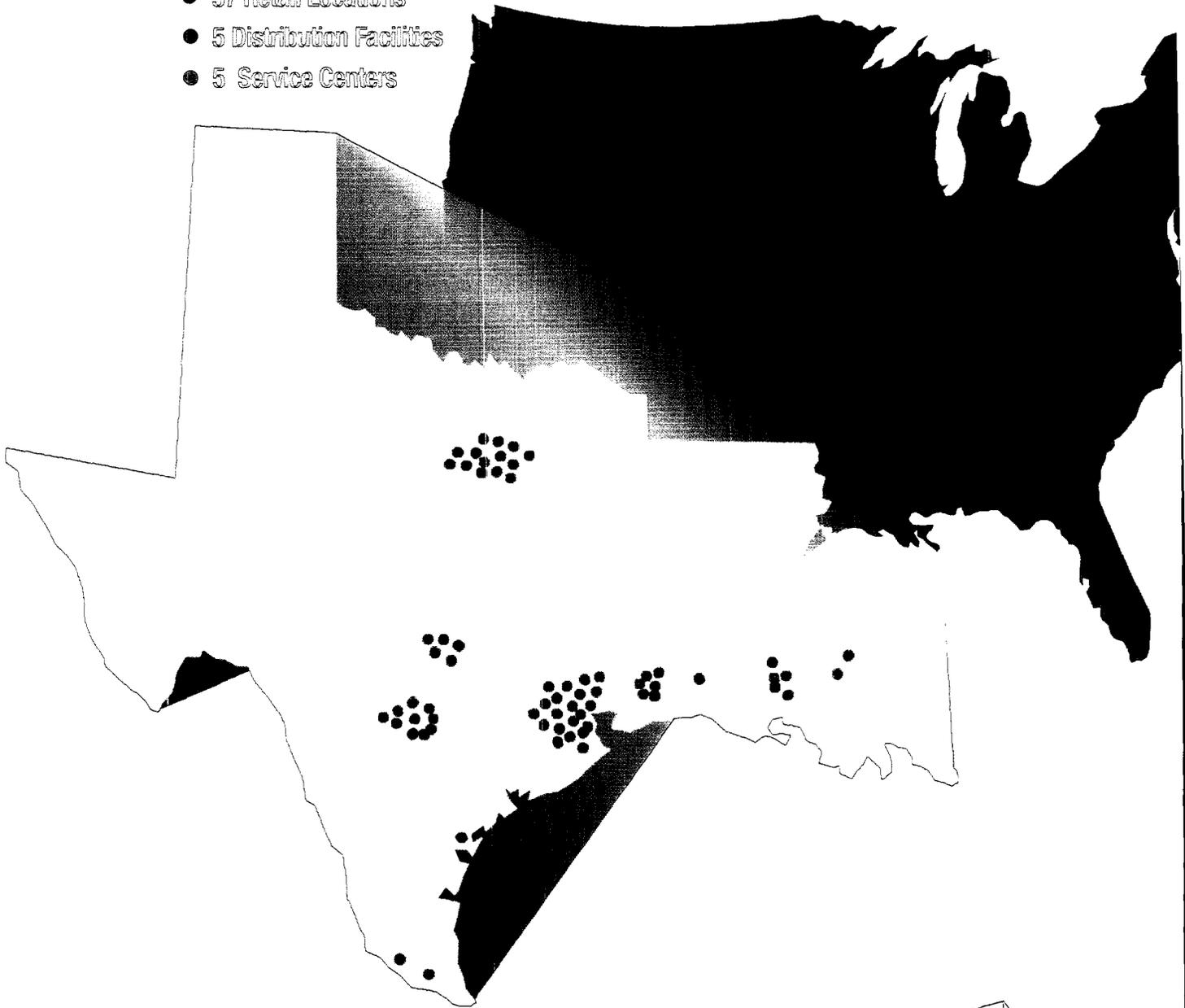
We paid the following fees to Ernst & Young for professional and other services rendered by them during fiscal 2005 and fiscal 2006:

	Years Ended January 31,		
	2004	2005	2006
Audit Fees.....	\$ 152,500	\$ 663,536	\$ 636,624
Audit-Related Fees.....	30,000	68,300	100,634
Tax Fees.....	-	-	-
All Other Fees (primarily IPO).....	670,895	-	-

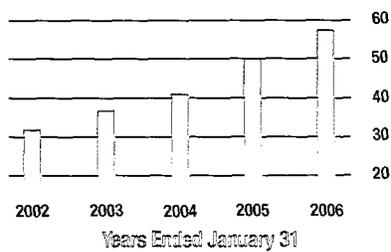
Our Audit Committee Charter requires pre-approval of all services to be rendered by our independent auditors. It was determined that no services rendered by our outside auditors in fiscal 2006 were prohibited under the new requirements of the Sarbanes-Oxley Act of 2002. Fees associated with the audit for fiscal 2006 were approved in advance of services being rendered. In addition, the Audit Committee has considered whether Ernst & Young's provision of services, other than services rendered in connection with the audit of our annual financial statements and reviews of our financial statements included in our Forms 10-Q for the most recent fiscal year, is compatible with maintaining Ernst & Young's independence and has determined that such services rendered met the requirements of independence.

# Conn's Market Coverage

- 57 Retail Locations
- 5 Distribution Facilities
- 5 Service Centers



Number of Stores





Conn's, Inc.  
3295 College St.  
Beaumont, TX 77701