

Edgar Filing: REX STORES CORP - Form 10-Q

REX STORES CORP
Form 10-Q
December 08, 2006

=====

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

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

FOR THE QUARTERLY PERIOD ENDED OCTOBER 31, 2006

OR

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER 001-09097

REX STORES CORPORATION
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE
(STATE OR OTHER JURISDICTION OF
INCORPORATION OR ORGANIZATION)

31-1095548
(I.R.S. EMPLOYER
IDENTIFICATION NUMBER)

2875 NEEDMORE ROAD, DAYTON, OHIO
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

45414
(ZIP CODE)

(937) 276-3931
(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

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

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

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

Edgar Filing: REX STORES CORP - Form 10-Q

At the close of business on December 7, 2006 the registrant had 10,344,888 shares of Common Stock, par value \$.01 per share, outstanding.

=====

REX STORES CORPORATION AND SUBSIDIARIES

INDEX

	Page
PART I. FINANCIAL INFORMATION	
Item 1. Consolidated Financial Statements	
Consolidated Condensed Balance Sheets	3
Consolidated Condensed Statements of Income	4
Consolidated Condensed Statements of Shareholders' Equity	5
Consolidated Condensed Statements of Cash Flows	6
Notes to Consolidated Condensed Financial Statements	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	20
Item 3. Quantitative and Qualitative Disclosures About Market Risk	29
Item 4. Controls and Procedures	29
PART II. OTHER INFORMATION	
Item 1A. Risk Factors	30
Item 6. Exhibits	30

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

REX STORES CORPORATION AND SUBSIDIARIES
CONSOLIDATED CONDENSED BALANCE SHEETS
UNAUDITED

	October 31 2006 ----	January 31 2006 ----
		(In Thousands)
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 15,923	\$ 21,363
Accounts receivable, net	3,757	3,457

Edgar Filing: REX STORES CORP - Form 10-Q

Synthetic fuel receivable	7,592	1,680
Merchandise inventory	116,065	97,371
Prepaid expenses and other	1,655	2,052
Future income tax benefits	9,588	9,361
	-----	-----
Total current assets	154,580	135,284
PROPERTY AND EQUIPMENT, NET	121,846	125,245
ASSETS HELD FOR SALE	1,497	1,497
OTHER ASSETS	7,193	760
GOODWILL	726	-
FUTURE INCOME TAX BENEFITS	28,397	30,031
INVESTMENTS	5,000	-
RESTRICTED INVESTMENTS	2,384	2,318
	-----	-----
Total assets	\$321,623	\$295,135
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current portion of long-term debt	\$ 2,354	\$ 2,389
Current portion of deferred income and deferred gain on sale and leaseback	11,176	10,883
Accounts payable, trade	23,153	20,396
Accrued income taxes	1,587	541
Accrued payroll and related items	4,302	7,183
Other current liabilities	6,300	5,863
	-----	-----
Total current liabilities	48,872	47,255
	-----	-----
LONG-TERM LIABILITIES:		
Long-term mortgage debt	21,454	21,462
Deferred income and deferred gain on sale and leaseback	13,106	12,213
	-----	-----
Total long-term liabilities	34,560	33,675
	-----	-----
MINORITY INTEREST	12,119	-
	-----	-----
SHAREHOLDERS' EQUITY:		
Common stock	295	294
Paid-in capital	138,700	135,775
Retained earnings	248,699	240,898
Treasury stock	(161,622)	(162,762)
	-----	-----
Total shareholders' equity	226,072	214,205
	-----	-----
Total liabilities and shareholders' equity	\$321,623	\$295,135
	=====	=====

The accompanying notes are an integral part of these unaudited consolidated condensed financial statements.

Edgar Filing: REX STORES CORP - Form 10-Q

REX STORES CORPORATION AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF INCOME
UNAUDITED

	Three Months Ended October 31	
	2006	2005
	-----	-----
	(In Thousands, Except as Noted)	
NET SALES AND REVENUE	\$85,215	\$91,759
Cost of sales	62,702	66,380
	-----	-----
Gross profit	22,513	25,379
Selling, general and administrative expenses	23,284	24,102
	-----	-----
OPERATING (LOSS) INCOME	(771)	1,277
INVESTMENT INCOME	341	23
INTEREST EXPENSE	(562)	(664)
GAIN ON SALE OF REAL ESTATE	462	253
INCOME FROM SYNTHETIC FUEL INVESTMENTS	5,865	8,433
	-----	-----
Income from continuing operations before provision for income taxes and discontinued operations	5,335	9,322
PROVISION FOR INCOME TAXES	1,713	2,251
	-----	-----
Income from continuing operations	3,622	7,071
Income (loss) from discontinued operations, net of tax	103	(189)
Gain on disposal of discontinued operations, net of tax	1,090	-
	-----	-----
NET INCOME	\$4,815	\$6,882
	=====	=====
WEIGHTED AVERAGE SHARES OUTSTANDING - BASIC	10,333	10,532
	=====	=====
Basic income per share from continuing operations	\$0.35	\$0.67
Basic income (loss) per share from discontinued operations	0.01	(0.02)
Basic income per share on disposal of discontinued operations	0.11	-
	-----	-----
BASIC NET INCOME PER SHARE	\$0.47	\$0.65
	=====	=====
WEIGHTED AVERAGE SHARES OUTSTANDING - DILUTED	11,517	11,865
	=====	=====
Diluted income per share from continuing operations	\$0.31	\$0.60
Diluted income (loss) per share from discontinued operations	0.01	(0.02)
Diluted income per share on disposal of discontinued operations	0.10	-
	-----	-----
DILUTED NET INCOME PER SHARE	\$0.42	\$0.58
	=====	=====

Edgar Filing: REX STORES CORP - Form 10-Q

The accompanying notes are an integral part of these unaudited consolidated condensed financial statements.

4

REX STORES CORPORATION AND SUBSIDIARIES
 CONSOLIDATED CONDENSED STATEMENTS OF SHAREHOLDERS' EQUITY
 UNAUDITED

	Common Shares				Paid-in Capital
	Issued		Treasury		
	Shares	Amount	Shares	Amount	
	-----	-----	-----	-----	-----
	(In Thousands)				
Balance at January 31, 2006	29,390	\$294	19,289	\$(162,762)	\$135,775
Net income					
Share-based compensation					1,297
Stock options exercised and related tax effects	101	1	(135)	1,140	1,628
Balance at October 31, 2006	----- 29,491 =====	----- \$295 =====	----- 19,154 =====	----- \$(161,622) =====	----- \$138,700 =====

	Common Shares				Paid-in Capital
	Issued		Treasury		
	Shares	Amount	Shares	Amount	
	-----	-----	-----	-----	-----
	(In Thousands)				
Balance at January 31, 2005	29,038	\$290	17,865	\$(137,839)	\$133,474
Net income					
Treasury stock acquired			1,697	(24,383)	
Stock options exercised and related tax effects	289	3	(627)	4,956	1,511
Balance at October 31, 2005	----- 29,327 =====	----- \$293 =====	----- 18,935 =====	----- \$(157,266) =====	----- \$134,985 =====

The accompanying notes are an integral part of these unaudited consolidated condensed financial statements.

Edgar Filing: REX STORES CORP - Form 10-Q

5

REX STORES CORPORATION AND SUBSIDIARIES
 CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
 UNAUDITED

	Ni
	2006

CASH FLOWS FROM OPERATING ACTIVITIES:	
Net income	\$
Adjustments to reconcile net income to net cash used in operating activities:	
Depreciation and amortization	
Stock based compensation expense	
Impairment charges	
Income from limited partnerships	(
Gain on disposal of fixed assets	(
Deferred income	
Excess tax benefits from stock option exercises	
Deferred income tax	
Changes in assets and liabilities:	
Accounts receivable	
Merchandise inventory	(1
Prepaid expenses and other	
Other long term assets	
Accounts payable, trade	
Other current liabilities	
NET CASH USED IN OPERATING ACTIVITIES	(1

CASH FLOWS FROM INVESTING ACTIVITIES:	
Capital expenditures	
Proceeds from sale of partnership interest	
Purchase of equity investment in ethanol	(
Purchase of note receivable	(
Repayment of note receivable	
Acquisition, net of cash acquired	
Proceeds from sale of real estate and fixed assets	
Restricted investments	
NET CASH PROVIDED BY INVESTING ACTIVITIES	----

CASH FLOWS FROM FINANCING ACTIVITIES:	
Proceeds from long-term debt	
Payments of long-term debt	(
Stock options exercised	
Excess tax benefits from stock option exercises	
Treasury stock acquired	
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	----

NET DECREASE IN CASH AND CASH EQUIVALENTS	(

Edgar Filing: REX STORES CORP - Form 10-Q

CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD

CASH AND CASH EQUIVALENTS, END OF PERIOD

The accompanying notes are an integral part of these unaudited consolidated condensed financial statements.

6

REX STORES CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS OCTOBER 31, 2006

NOTE 1. CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

The consolidated condensed financial statements included in this report have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission and include, in the opinion of management, all adjustments necessary to state fairly the information set forth therein. Any such adjustments were of a normal recurring nature. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading. It is suggested that these unaudited consolidated condensed financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended January 31, 2006 (fiscal 2005). The results of operations for the interim periods are not necessarily indicative of the results to be expected for the year.

Basis of Consolidation - The consolidated condensed financial statements in this report include the operating results and financial position of REX Stores Corporation and its wholly-owned subsidiaries and all variable interest entities where the Company has been determined to be the primary beneficiary. Levelland/Hockley County Ethanol, LLC ("Levelland/Hockley") qualifies as a Variable Interest Entity ("VIE"), but not a Special Purpose Entity under FASB Interpretation No. 46R ("FIN 46R"), "Consolidation of Variable Interest Entities". The Company is the primary beneficiary of Levelland/Hockley, and in accordance with FIN 46R, the Company consolidated Levelland/Hockley effective with the third quarter of fiscal 2006. The Company includes the results of operations of Levelland/Hockley in its Consolidated Condensed Statement of Income on a delayed basis of one fiscal quarter.

NOTE 2. RECLASSIFICATIONS

The Company reclassified \$0.3 million and \$0.7 million of lease income from selling, general and administrative expenses to net sales and revenue for the quarter and nine months ended October 31, 2005, respectively, to conform to current year presentation. The Company reclassified \$1.3 million of outstanding checks from accounts payable to cash at January 31, 2006 to conform to current year presentation.

NOTE 3. ACCOUNTING POLICIES

Edgar Filing: REX STORES CORP - Form 10-Q

The interim consolidated condensed financial statements have been prepared in accordance with the accounting policies described in the notes to the consolidated financial statements included in the Company's 2005 Annual Report on Form 10-K. While management believes that the procedures followed in the preparation of interim financial information are reasonable, the accuracy of some estimated amounts is dependent upon facts that will exist or calculations that will be accomplished at fiscal year end. Examples of such estimates include management bonuses, income

7

from synthetic fuel limited partnership sales and the provision for income taxes. Any adjustments pursuant to such estimates during the quarter were of a normal recurring nature. Actual results could differ from those estimates.

The following table reflects the approximate percent of net sales and revenue for each major product group for the periods presented.

Product Category -----	Three Months Ended October 31 -----	2006 ----	2005 ----
Televisions.....	55.1%		56.6%
Appliances.....	27.3		24.2
Audio.....	5.9		7.6
Video.....	3.6		4.5
Other.....	8.1		7.1
	-----		-----
	100.0%		100.0%
	=====		=====

Vendors often fund, up front, certain advertising costs and exposure to general changes in pricing to customers due to technological change. Allowances are deferred as received from vendors and recognized into income as an offset to the cost of merchandise sold when the related product is sold or expense incurred. Advertising costs are expensed as incurred.

The Company recognizes income from synthetic fuel partnership sales as the synthetic fuel is produced and sold. The Company estimates the impact of oil prices and the likelihood of any phase out of Section 29/45K credits and the resulting reduction of synthetic fuel income quarterly. See Note 10 for a further discussion of synthetic fuel partnership sales.

Cost of sales includes the cost of merchandise (net of vendor allowances), markdowns and inventory shrink, receiving, warehousing and freight charges to deliver merchandise to retail stores, service repair bills as well as cash discounts and rebates. The Company classifies purchasing costs as selling, general and administrative expenses. As a result of this classification, the Company's gross margins may not be comparable to those of other retailers that include costs related to their distribution network in selling, general and administrative expense.

Edgar Filing: REX STORES CORP - Form 10-Q

The Company includes stores expenses (such as payroll and occupancy costs), advertising, purchasing, depreciation, insurance and overhead costs in selling, general and administrative expenses.

Interest expense was \$1,549,000 for the nine months ended October 31, 2006 and no interest was capitalized. Interest expense of \$1,946,000 for the nine months ended October 31, 2005 is net of approximately \$15,000 of interest capitalized. Cash paid for interest for the nine months ended October 31, 2006 and 2005 was approximately \$1,483,000 and \$1,907,000, respectively.

The Company applies an effective tax rate to interim periods that is consistent with the Company's estimated annual tax rate. The Company provides for deferred tax liabilities and assets for the future tax consequences attributable to differences between the financial statement carrying

8

amounts of existing assets and liabilities and their respective tax basis and operating loss and tax credit carryforwards. The Company provides for a valuation allowance if, based on the weight of available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

The Company paid income taxes of approximately \$0.1 million and \$4.5 million for the nine months ended October 31, 2006 and 2005, respectively.

From time to time, in advance of making an investment in debt or equity securities of investees, such as the contingent investments the Company has in ethanol entities, the Company may enter into a commitment for such investment which is contingent upon future events occurring, including but not limited to, the investee raising additional financing and/or equity. These commitments may be backed by letters of credit or other means as mutually agreed to by the Company and the investee. Generally, because commitments are contingently exercisable and represent the potential acquisition of a minority position in the investee, the Company believes that it is not the primary beneficiary of the investee under the guidance in FASB Interpretation Number 46R ("FIN 46R"). When, and if the commitment is exercised and the Company makes its investment, the Company is required to re-evaluate whether the Company is the primary beneficiary under the guidance in FIN 46R.

The method of accounting applied to long-term investments, whether consolidated, equity or cost, involves an evaluation of the significant terms of each investment that explicitly grant or suggest evidence of control or influence over the operations of the investee and also includes the identification of any variable interests in which the Company is the primary beneficiary. See Note 4 for a further discussion of the acquisition of Levelland/Hockley. Investments in businesses that the Company does not control, but has the ability to exercise significant influence over operating and financial matters, are accounted for using the equity method. An equity investment of \$5 million in Big River Resources, LLC ("Big River") is accounted for using the equity method. The investment in Big River represents an ownership interest of 4.3%. Big River is an Iowa limited liability company and holding company for several entities including Big River Resources West Burlington, LLC which presently operates a 52 million gallon ethanol manufacturing facility. Investments in which the Company does not have the ability to exercise significant influence over operating and financial matters are accounted for using the cost method. All intercompany transactions between the consolidated

Edgar Filing: REX STORES CORP - Form 10-Q

subsidiaries are eliminated.

Investments in debt securities are considered "held to maturity", "available for sale", or "trading securities" under Statement of Financial Accounting Standards (SFAS) No. 115, Accounting for Certain Investments in Debt and Equity Securities ("SFAS 115".) Under SFAS 115, held to maturity securities are required to be carried at their cost; while available-for-sale securities are required to be carried at their fair value, with unrealized gains and losses, net of income taxes, that are considered temporary in nature recorded in accumulated other comprehensive income (loss) in the accompanying consolidated condensed balance sheets. The fair values of the Company's investments in debt securities are determined based upon market quotations and various valuation techniques, including discounted cash flow analysis. The Company periodically evaluates its investments in debt securities for impairment due to declines in market value considered to be other than temporary. Such impairment evaluations include, in addition to persistent, declining market prices, general

9

economic and company-specific evaluations. If the Company determines that a decline in market value is other than temporary, then a charge to earnings is recorded in investment and other income (expense), net in the accompanying consolidated income statements for all or a portion of the unrealized loss, and a new cost basis in the investment is established. Restricted investments of \$2.4 million, which are principally marketable debt securities of a federal government agency, are classified as held to maturity, and are stated as cost plus accrued interest, which approximates market.

RECENTLY ISSUED ACCOUNTING STANDARDS

In July 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 48 ("FIN 48") "Accounting for Uncertainty in Income Taxes" which prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. Additionally, FIN 48 provides guidance on the derecognition, classification, accounting in interim periods and disclosure requirements for uncertain tax positions. The provisions of FIN 48 will be effective for the Company beginning February 1, 2007. The Company is in the process of determining the effect, if any, the adoption of FIN 48 will have on its financial statements.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108 ("SAB 108"), "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements." SAB 108 provides interpretative guidance on the process of quantifying financial statement misstatements and is effective for fiscal years ending after November 15, 2006. The Company applied the provisions of SAB 108 in the third quarter of fiscal 2006 and there was no impact to the financial statements.

NOTE 4. BUSINESS COMBINATIONS

On September 30, 2006, the Company acquired 47 percent of the outstanding membership units of Levelland/Hockley County Ethanol, LLC ("Levelland/Hockley"). The results of Levelland/Hockley's operations have not been included in the consolidated financial statements subsequent to the

Edgar Filing: REX STORES CORP - Form 10-Q

acquisition date as the Company records Levelland/Hockley' results of operations on a delayed basis of one fiscal quarter. The aggregate purchase price was \$11.5 million, all of which was cash.

10

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition. The allocation of the purchase price to the assets and liabilities of the Levelland/Hockley acquisition is based upon preliminary estimates and is therefore subject to change.

(In thousands)

Cash	\$ 13,165
Accrued interest receivable	24
Property, plant and equipment	4,046
Intangible assets	1,015
Deposits	5,220
Goodwill	726

Total assets acquired	24,196
Current liabilities	(577)
Minority interest	(12,119)

Net purchase price	\$ 11,500
	=====

The intangible assets represent prepaid loan fees and have an estimated useful life of 6 years. None of the goodwill is expected to be deductible for income tax purposes. Levelland/Hockley is a development stage entity that plans to commence construction of an ethanol production facility in Levelland, Texas, which will have a design capacity of 40 million gallons of ethanol annually. The purchase, along with the Company's \$5 million convertible secured promissory note commitment, enables the Company to secure a majority equity interest in Levelland/Hockley.

The unaudited financial information in the table below summarizes the combined results of operations of the Company and Levelland/Hockley, on a pro forma basis, as though the companies had been combined as of the beginning of each of the periods presented. The pro forma financial information is presented for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisitions had taken place at the beginning of each of the periods presented. The pro forma financial information for all periods presented includes adjustments to interest income and expense and related income tax effects.

(In thousands, except per share data)

	Quarter Ended October 31, 2006	-----
Net sales and revenue	\$ 85,215	
Net income	\$ 4,536	
Basic net income per share	\$ 0.44	
Diluted net income per share	\$ 0.39	

Edgar Filing: REX STORES CORP - Form 10-Q

(In thousands, except per share data)

Nine Months Ended
October 31, 2006

Nine
Octo

Net sales and revenue	\$ 251,495
Net income	\$ 7,321
Basic net income per share	\$ 0.71
Diluted net income per share	\$ 0.63

11

NOTE 5. OTHER ASSETS

The components of other assets at October 31, 2006 and 2005 are as follows (amounts in thousands):

	2006	2005
	----	----
Contract deposits	\$5,220	\$ -
Prepaid loan fees	2,057	712
Other	221	111
	---	---
Total	7,498	823
Less current portion	305	-
	-----	----
Long term	\$7,193	\$823
	=====	====

Contract deposits represent amounts paid in advance for the contract to construct the facility in which Levelland/Hockley intends to produce ethanol. This amount will be depreciated over the estimated useful lives of the plant and equipment, which is expected to be ten to twenty years.

Prepaid loans fees represent amounts paid to obtain both mortgage debt and borrowings under the Company's line of credit. Such amounts are amortized as interest expense. Future amortization expense is as follows (amounts in thousands):

YEAR ENDED

Remainder of January 31, 2007	\$148
January 31, 2008	\$459
January 31, 2009	\$456
January 31, 2010	\$342
January 31, 2011	\$190
Thereafter	\$462

NOTE 6. LONG TERM DEBT

The Company borrowed \$3.1 million by obtaining two mortgage loans during the third quarter of fiscal 2006. One of the mortgage loans had an original principal balance of \$1.6 million bearing interest at a variable rate of prime minus 0.25 percent (presently 8.0%) and is payable over 5 years. The other mortgage loan had an original principal balance of \$1.5 million bearing interest at a fixed rate of 8.0% and is payable over 15 years.

Edgar Filing: REX STORES CORP - Form 10-Q

NOTE 7. STOCK OPTION PLANS

The Company has stock-based compensation plans under which stock options have been granted to directors, officers and key employees at the market price on the date of the grant.

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), SHARE-BASED PAYMENT ("SFAS

12

123(R)"), which requires the recognition of the cost of employee services received in exchange for an award of equity instruments in the financial statements and measurement based on the grant-date fair value of the award. It also requires the cost to be recognized over the period during which an employee is required to provide service in exchange for the award (presumptively the vesting period.) SFAS 123(R) replaces SFAS No. 123, ACCOUNTING FOR STOCK-BASED COMPENSATION, and supersedes Accounting Principles Board Opinion No. 25, ACCOUNTING FOR STOCK ISSUED TO EMPLOYEES ("APB25"), and its related interpretations. The Company adopted SFAS 123(R) on February 1, 2006. The Company chose the Modified Prospective Application ("MPA") method for implementing SFAS 123(R). Under the MPA method, new awards, if any, are valued and accounted for prospectively upon adoption. Outstanding prior awards that are unvested as of February 1, 2006 will be recognized as compensation cost over the remaining requisite service period. Prior periods have not been restated.

On May 26, 2005, the Company's Board of Directors approved accelerating the vesting of out-of-the-money, unvested stock options held by current employees, including non-director executive officers. An option was considered out-of-the-money if the stated option exercise price was greater than \$13.82, which was the closing price of the Company's common stock on May 26, 2005. As a result, options to purchase approximately 118,000 shares, including options to purchase approximately 60,000 shares held by executive officers, became immediately exercisable. The decision to accelerate vesting of these options was made to avoid recognizing compensation cost in the consolidated statement of income upon the adoption of SFAS 123(R). As a result of the acceleration, stock option expense was reduced by approximately \$542,000 (\$336,000 net of tax) in the first nine months of fiscal 2006 under the MPA.

Prior to its adoption of SFAS 123(R), the Company accounted for stock-based compensation in compliance with APB 25, under which no compensation cost was recognized. The Company provided disclosures based on the fair value as permitted by SFAS 123.

In the third quarter of fiscal 2006, the adoption of SFAS 123(R) resulted in incremental stock-based compensation expense of approximately \$363,000 (\$225,000 net of tax, or \$0.02 per basic and diluted share.) In the first nine months of fiscal 2006, the adoption of SFAS 123(R) resulted in incremental stock-based compensation expense of approximately \$1,297,000 (\$804,000 net of tax, or \$0.08 per basic and \$0.07 per diluted share.) Prior to the adoption of SFAS 123(R), the Company reported all tax benefits resulting from the exercise of non-qualified stock options as operating cash flows in its consolidated statements of cash flows. In accordance with SFAS 123(R), the Company revised its current year statement of cash flows presentation to report the excess tax benefits from the exercise of non-qualified stock options as financing cash flows. There were approximately \$24,000 of excess tax benefits

Edgar Filing: REX STORES CORP - Form 10-Q

from the exercise of non-qualified stock options for the nine months ended October 31, 2006.

SFAS 123 requires the presentation of pro forma information for the comparative period prior to the adoption as if all of the Company's employee stock options had been accounted under the fair value method of the original SFAS 123.

13

Had compensation cost for all options granted been determined based on the fair value at grant date consistent with SFAS 123, the Company's net earnings and earnings per share would have been as follows (in thousands, except per share amounts):

		Three Months Ended October 31, 2005 -----
Net income	As Reported	\$6,882
	Compensation Cost, net of tax	625
	Pro forma	6,257
Basic net income per share	As Reported	\$ 0.65
	Compensation Cost, net of tax	0.06
	Pro forma	0.59
Diluted net income per share	As Reported	\$ 0.58
	Compensation Cost, net of tax	0.05
	Pro forma	0.53

No options have been granted since fiscal 2004. The fair values of options granted were estimated as of the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions used for grants in fiscal years ended January 31, 2005 and 2004, respectively: risk-free interest rate of 4.7% and 4.3%, expected volatility of 65.4% and 65.9% and a weighted average stock option life of nine years for all years.

The total intrinsic value of options exercised during the nine months ended October 31, 2006 and 2005 was approximately \$2.3 million and \$8.2 million, respectively, resulting in tax deductions to realize benefits of approximately \$1.0 million and \$1.8 million, respectively.

14

The following table summarizes options granted, exercised and canceled or expired during the nine months ended October 31, 2006:

Edgar Filing: REX STORES CORP - Form 10-Q

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term
Outstanding at January 31, 2006	4,673,721	\$8.15	
Exercised	(235,642)	\$7.19	
Forfeited	(4,200)	\$12.69	
	-----	-----	
Outstanding at October 31, 2006	4,433,879	\$8.20	4.0
	=====	=====	===
Exercisable at October 31, 2006	4,094,020	\$7.83	3.8
	=====	=====	===

At October 31, 2006, there was approximately \$3.2 million (pre-tax) of unrecognized compensation cost related to nonvested stock options, which is expected to be recognized over a weighted average period of 2.3 years.

NOTE 8. SALE AND LEASEBACK TRANSACTION

On July 28, 2006, the Company completed a transaction for the sale and leaseback of one of its stores under an initial three-year lease term. A pre-tax financial statement gain of \$1.7 million (net of expenses) resulted from this sale. The Company has also deferred \$0.6 million, which represents the present value of the minimum lease payments and will amortize this deferred gain as a reduction to lease expense over the lease term. The lease has been accounted for as an operating lease.

15

NOTE 9. INCOME PER SHARE FROM CONTINUING OPERATIONS

The following table reconciles the basic and diluted net income per share from continuing operations computation for each period presented (in thousands, except per share amounts):

	Three Months Ended October 31, 2006			
	Income	Shares	Per Share	Income
	-----	-----	-----	-----
Basic income per share from continuing operations	\$3,622	10,333	\$0.35	\$6,879
			=====	
Effect of stock options	-----	1,184		-----
Diluted income per share from continuing operations	\$3,622	11,517	\$0.31	\$6,540
	=====	=====	=====	=====

Edgar Filing: REX STORES CORP - Form 10-Q

	Three Months Ended October 31, 2005 -----			
	Income -----	Shares -----	Per Share -----	Income -----
Basic income per share from continuing operations	\$7,071	10,532	\$0.67 =====	\$22,12
Effect of stock options	-----	1,333		-----
Diluted income per share from continuing operations	\$7,071 =====	11,865 =====	\$0.60 =====	\$22,12 =====

For the three months ended October 31, 2006 and 2005, a total of 620,820 shares and 303,502 shares, respectively, and for the nine months ended October 31, 2006 and 2005, a total of 354,820 shares and 303,502 shares, respectively, subject to outstanding options were not included in the common equivalent shares outstanding calculation as the effect from these shares was antidilutive.

NOTE 10. SYNTHETIC FUEL

Income from continuing operations for the third quarter and first nine months of fiscal 2006 includes approximately \$2.8 million and \$4.2 million, respectively, of pre-tax investment income from the sales of the Company's entire partnership interest in Colona SynFuel Limited Partnership, L.L.L.P., (Colona). The Company was to receive payments from the three separate sales of its interests in Colona, on a quarterly basis through 2007, ranging from 74.25% to 82.5% of the federal income tax credits attributable to the interest sold subject to certain annual limitations and production levels. The Company has agreed to accept payments for calendar year 2006 production in 2007 after the 2006 "Annual Adjustment Amount" is published by the Internal Revenue Service. During the first quarter of fiscal 2006, the Company recorded approximately \$504,000 of income which relates to a payment received for 2005 production. The 2005 production payments were based upon estimated income tax credits per ton of coal produced. The \$504,000 payment was made to the Company after the Internal Revenue Service published the 2005 income tax credit per ton amount in April of 2006.

During the first quarter of fiscal 2005, the Company recorded approximately \$448,000 of income which relates to a payment received for 2004 production. The 2004 production payments were based upon estimated income tax credits per ton of coal produced. The \$448,000 payment was made to the Company after the Internal Revenue Service published the 2004 income tax credit per ton amount in April of 2005. The Company recognized income of approximately \$121,000 in the third quarter of fiscal 2006 that related to production occurring in the quarter. The Company recognized income of approximately \$2,712,000 in the third quarter of fiscal 2006 that related to previously unrecognized income as a result of changes in the Company's estimates of the phase out of Section 29/45K credits as a result of the price of oil.

Edgar Filing: REX STORES CORP - Form 10-Q

Income from continuing operations for the third quarter and first nine months of fiscal 2006 includes approximately \$2.4 million and \$3.3 million, respectively, of pre-tax investment income from the sale of the Company's entire partnership interest in Somerset Synfuel, L.P. (Somerset), which produces synthetic fuel. Effective October 1, 2005, the Company sold its entire ownership interest in Somerset, which owned two synthetic fuel facilities. The Company received \$1.2 million, net of commissions, at closing along with a secured contingent payment note that could provide additional investment income. The Company expects to receive quarterly payments through 2007 equal to 80% of the Section 29/45K tax credits attributable to the ownership interest sold, subject to production levels. During the first quarter of fiscal 2006, the Company recorded approximately \$58,000 of income which relates to 2005 production. The 2005 production payments were based upon estimated income tax credits per ton of coal produced. The \$58,000 was recognized after the Internal Revenue Service published the 2005 income tax credit per ton amount in April of 2006. The Company recognized income of approximately \$1,147,000 in the third quarter of fiscal 2006 that related to production occurring in the quarter. The Company recognized income of approximately \$1,249,000 in the third quarter of fiscal 2006 that related to previously unrecognized income as a result of changes in the Company's estimates of the phase out of Section 29/45K credits as a result of the price of oil.

Income from synthetic fuel investments for the third quarter and first nine months of fiscal 2006 also includes approximately \$0.6 million and \$1.1 million, respectively of pre-tax investment income from the sale of the Company's entire membership interest in the limited liability company that owned a synthetic fuel facility in Gillette, Wyoming. The Company received \$2.8 million at the time of sale on March 30, 2004 along with a secured contingent payment note that could provide additional income. The facility resumed commercial operations during the second quarter of fiscal 2005; as such, the Company received \$3.5 million as a one-time payment per the terms of the purchase agreement. In addition, the Company is eligible to receive \$1.50 per ton of "qualified production" produced by the facility and sold through 2007. Payments for qualified production occurring after January 31, 2006 through March 31, 2006 have been placed into escrow. Subject to certain conditions, the Company may receive certain payments placed into escrow in calendar year 2007 after information necessary to calculate any phase out of Section 29/45K credits is published by the Department of Treasury. The Company recognized income of approximately \$635,000 in the third quarter of fiscal 2006 that related to previously unrecognized income as a result of changes in the Company's estimates of the phase out of Section 29/45K credits as a result of the price of oil. During the third quarter of fiscal 2006, the Company entered into an agreement with the owners and operators of the synthetic fuel facility. Based on the terms of the agreement, the Company may currently not be able to determine the likelihood of collecting payments related to production

17

occurring after September 30, 2006. Thus, the Company cannot currently determine the impact and timing of income recognition related to production occurring after September 30, 2006.

As provided by the current Internal Revenue Code, the Code Section 29/45K tax credit program is expected to continue through December 31, 2007; however, recent increases in the price of oil could limit the amount of those credits or eliminate them altogether for 2006 and 2007. This possibility is due

Edgar Filing: REX STORES CORP - Form 10-Q

to a provision of Section 29/45K that provides that if the average wellhead price per barrel for unregulated domestic crude oil for the year (the "Annual Average Price") exceeds a certain threshold value (the "Threshold Price"), the Section 29/45K tax credits are subject to phase out. For calendar year 2005, the Threshold Price was \$53.20 per barrel and the Phase Out Price was \$66.78 per barrel. The Threshold Price and the Phase Out Price are adjusted annually as a result of inflation and are published by the Internal Revenue Service in April of the following year.

The Company cannot predict with absolute certainty the Annual Average Price for 2006 or beyond. Therefore, it cannot predict whether the price of oil will have a material effect on its synthetic fuel business after 2005. However, if during 2006 or 2007 oil prices remain at historically high levels or increase, such that the Annual Average Price exceeds the Threshold Price, the Company's synthetic fuel business may be adversely affected for those years, and, depending on the magnitude of such increases in oil prices, the adverse effect for those years could be material and could have an impact on the Company's synthetic fuel results of operations. Based upon the price of oil to date and considering the NYMEX futures market, the Company estimates the tax credits would be subject to approximately a 40% phase out as of October 31, 2006. Because synthetic fuel is not economical to produce absent the associated tax credits and the fact that the Company has no control or decision involvement with production levels, the Company cannot determine the impact of possible production reduction or elimination on the Company's financial results.

Below is a table summarizing the income from the sales, net of certain expenses, of the Company's interests in synthetic fuel entities (in thousands):

	Three Months Ended October 31,	
	2006	2005
	----	----
February 1, 1999 Colona sale.....	\$1,130	\$2,149
July 31, 2000 Colona sale.....	902	2,058
May 31, 2001 Colona sale.....	802	1,829
October 1, 2005 Somerset sale.....	2,396	1,178
March 30, 2004 Gillette sale.....	635	1,219
	-----	-----
	\$5,865	\$8,433
	=====	=====

NOTE 11. DISCONTINUED OPERATIONS AND ASSETS HELD FOR SALE

During the first nine months of fiscal 2006 the Company closed eight stores in which the Company vacated the market or will not have a further continuing involvement with the related property. Those stores and certain other stores closed in

previous periods or scheduled to be closed in the next twelve months were

Edgar Filing: REX STORES CORP - Form 10-Q

classified as discontinued operations for all periods presented. Two of the closed stores are classified as held for sale. The net assets of those stores at October 31, 2006 were approximately \$1.5 million. The Company expects to sell the assets related to these stores within the next 12 months through normal real estate channels.

Below is a table reflecting certain items of the income statement that were reclassified as discontinued operations for the period indicated.

	Three Months Ended October 31,		
	2006	2005	2004
	(In Thousands)		
Net sales and revenue.....	\$1,298	\$3,637	\$4,125
Cost of merchandise sold	1,138	2,759	3,012
Income (loss) before income taxes	159	(291)	(887)
(Provision) benefit for income taxes.....	(56)	102	(10)
Net income (loss).....	\$103	\$(189)	\$(997)

NOTE 12. COMMITMENTS

On November 28, 2005, the Company entered into a contingent agreement with Levelland/Hockley to purchase a convertible secured promissory note in the principal amount of \$5 million. The proceeds of the note will be used to capitalize Levelland/Hockley which intends to construct and, subsequently, operate an ethanol producing facility. The facility is expected to have a design capacity of 40 million gallons annually. The purchase of the note is expected to occur before December 31, 2006, subject to certain conditions.

On July 27, 2006, the Company entered into a contingent agreement with Levelland/Hockley to make an equity investment ranging from \$11.5 to \$18.0 million. The Company has funded \$11.5 million of this commitment. The Company may, subject to certain conditions, invest up to an additional \$6.5 million.

On March 17, 2006, the Company entered into a contingent agreement to purchase a note in the principal amount of \$14 million to be issued by Millennium Ethanol, LLC ("Millennium") which has commenced construction of an ethanol producing facility in Marion, South Dakota. The facility is expected to have a design capacity of 100 million gallons annually. The Company expects to fund the note in December 2006 as all conditions necessary for the Company to fund the note have been satisfied. The Company has obtained a \$14 million irrevocable letter of credit to secure its purchase obligation. The note purchase agreement provides the Company rights to purchase a minority equity interest in Millennium in exchange for the note. At October 31, 2006, the \$14 million letter of credit remained outstanding.

On May 26, 2006, the Company entered into a contingent agreement to invest \$24.9 million in One Earth Energy, LLC ("One Earth") which was organized to construct and, subsequently, operate an ethanol producing facility in Gibson City, Illinois. The facility is expected to have a design

Edgar Filing: REX STORES CORP - Form 10-Q

capacity of 100 million gallons annually. The equity investment is expected to occur before June 30, 2007, subject to One Earth obtaining additional financing and certain other conditions.

On June 8, 2006, the Company entered into a contingent agreement to invest \$16 million in Patriot Renewable Fuels, LLC ("Patriot") which has commenced construction of an ethanol producing facility in Annawon, Illinois. The facility is expected to have a design capacity of 100 million gallons annually. The equity investment is expected to occur before December 31, 2006, subject to Patriot obtaining additional financing and certain other conditions. See Note 13 for a discussion of subsequent events affecting this commitment.

On October 1, 2006, the Company entered into an agreement to invest \$20 million in Big River Resources, LLC ("Big River".) The Company has funded \$5 million of this investment in exchange for a 4.3% ownership interest. The remaining \$15 million investment is expected to occur in fiscal 2007, subject to certain conditions. The Company's final ownership percentage will be determined once Big River has obtained all funding.

NOTE 13. SUBSEQUENT EVENTS

In November 2006, the Company entered into 12 mortgage loan agreements to borrow approximately \$10.0 million. The loans are secured by real estate, payable over 10 years and bear interest at a fixed rate of 7.31%.

On November 29, 2006, the Company received notice that all conditions necessary for the Company to fund \$16 million in Patriot have been satisfied. The Company funded the equity investment on December 4, 2006.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

We are a specialty retailer in the consumer electronics/appliance industry. As of October 31, 2006 we operated 207 stores in 36 states, predominantly in small to medium-sized markets under the trade name "REX". Over the past eight years, we have also been active in several synthetic fuel investments and as of October 31, 2006, we had funded two ethanol producing entities and had contingent agreements to fund three additional ethanol producing entities.

FISCAL YEAR

All references in this report to a particular fiscal year are to REX's fiscal year ended January 31. For example, "fiscal 2006" means the period February 1, 2006 to January 31, 2007.

RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, the relative percentages that certain income and expense items bear to net sales and revenue:

Edgar Filing: REX STORES CORP - Form 10-Q

	Three Months Ended October 31		2006
	2006	2005	
Net sales and revenue.....	100.0%	100.0%	100.0
Cost of merchandise sold.....	73.6	72.3	72.7
Gross profit.....	26.4	27.7	27.3
Selling, general and administrative expenses.....	27.3	26.3	27.2
Operating (loss) income.....	(0.9)	1.4	0.1
Investment income.....	0.4	-	0.4
Interest expense.....	(0.6)	(0.7)	(0.6)
Gain on sale of real estate.....	0.5	0.3	0.9
Income from synthetic fuel investments.....	6.9	9.2	3.4
Income from continuing operations before provision for income taxes and discontinued operations.....	6.3	10.2	4.2
Provision for income taxes.....	1.9	2.5	1.5
Income from continuing operations.....	4.4	7.7	2.7
Loss from discontinued operations, net of tax.....	-	(0.2)	-
Gain on disposal of discontinued operations, net of tax	1.3	-	0.4
Net income.....	5.7%	7.5%	3.1

COMPARISON OF THREE MONTHS AND NINE MONTHS ENDED OCTOBER 31, 2006 AND 2005

Net sales and revenue in the quarter ended October 31, 2006 were \$85.2 million compared to \$91.8 million in the prior year's third quarter, representing a decrease of \$6.6 million or 7.2%. Net sales and revenue do not include sales from stores classified in discontinued operations.

This decrease was primarily caused by a decrease in comparable store sales of 5.6% for the third quarter of fiscal 2006, which accounted for approximately \$3.4 million of the decrease. We consider a store to be comparable after it has been open six full fiscal quarters. Comparable store sales do not include sales of extended service contracts. In addition, the decrease was caused by a net reduction of 19 stores (11 of which were classified as discontinued operations) since the end of the third quarter of fiscal 2005. The reduction in stores accounted for approximately \$3.2 million of the decrease.

Our strongest product category for the third quarter of fiscal 2006 was the appliance category which positively impacted comparable store sales by 1.7%. This increase is primarily related to an increased promotional effort and an increase in the breadth of products offered. The television

Edgar Filing: REX STORES CORP - Form 10-Q

category negatively impacted comparable store sales by 3.8%. We continue to experience growth in LCD and plasma sets, however, the growth was offset by declines in other television sets. The audio category negatively impacted comparable store sales by 1.7%. The video category negatively impacted comparable store sales by 1.0%. Both the audio and video categories have been impacted by lower price points of their respective products, as these products are becoming more of a commodity item with very high levels of competition.

Net sales and revenue for the first nine months of fiscal 2006 were \$251.5 million compared to \$259.6 million for the first nine months of fiscal 2005. This represents a decrease of \$8.1 million or 3.1%. This decrease was primarily caused by a net reduction of 19 stores (11 of which were classified as discontinued operations) since the end of the third quarter of fiscal 2005. The reduction in stores accounted for approximately \$8.0 million of the decrease. This decrease was also caused by a decrease in comparable store sales of 0.7% for the first nine months of fiscal 2006.

The appliance category positively impacted comparable store sales for the first nine months of fiscal 2006 by 3.7%. The appliance category increase is primarily related to an increased promotional effort and an increase in the breadth of products offered. The television, audio and video categories negatively impacted comparable store sales for the first nine months of fiscal 2006 by 0.6%, 2.2% and 1.3%, respectively. We experienced growth in LCD and plasma sets, however, the growth was offset by declines in other television sets. Both the audio and video categories reflect a continuing trend of lower price points of the respective products, as these products are becoming more of a commodity item with very high levels of competition.

The following table reflects the approximate percent of net sales and revenue for each major product group for the periods presented.

Product Category	Three Months Ended October 31		Nine Months October
	2006	2005	2006
Televisions.....	55.1%	56.6%	53.1%
Appliances.....	27.3	24.2	28.0
Audio.....	5.9	7.6	7.1
Video.....	3.6	4.5	3.7
Other.....	8.1	7.1	8.1
	-----	-----	-----
	100.0%	100.0%	100.0%
	=====	=====	=====

As of October 31, 2006, we operated 207 stores compared to 226 stores one year earlier. We did not open any stores and closed 11 stores during the first nine months of fiscal 2006. Of the 11 stores closed, we have lease agreements, as landlord, for four of the locations. We abandoned three of the stores upon the expiration of our lease as lessee and sold four of the stores we owned. We did not open any stores and closed eight stores during the first nine months of fiscal 2005.

At October 31, 2006, we had lease agreements, as landlord/sub landlord, for all or parts of 24 properties. We own 21 of these properties and are the

Edgar Filing: REX STORES CORP - Form 10-Q

tenant/sub landlord for three of the properties. In eight of the owned locations, we operate a store and lease a portion of the property to another party.

22

We do not operate a store in 13 of the owned properties. We have two owned properties that are vacant and classified as assets held for sale at October 31, 2006.

Gross profit of \$22.5 million (26.4% of net sales and revenue) in the third quarter of fiscal 2006 was approximately \$2.9 million lower than the \$25.4 million (27.7% of net sales and revenue) recorded in the third quarter of fiscal 2005. Gross profit for the first nine months of fiscal 2006 was \$68.8 million (27.3% of net sales and revenue) compared to \$73.4 million (28.3% of net sales and revenue) for the first nine months of fiscal 2005. Gross profit margin for the third quarter and first nine months of fiscal 2006 was negatively impacted by approximately \$0.7 million and \$1.9 million, respectively, as a result of having 19 net fewer stores compared to the prior year. Gross profit margin for the third quarter and first nine months of fiscal 2006 was negatively impacted by a change in product mix, a competitive market environment, and a focused effort to sell slow moving or aged inventory.

Selling, general and administrative expenses for the third quarter of fiscal 2006 were \$23.3 million (27.3% of net sales and revenue), a decrease of \$0.8 million or 3.3% from \$24.1 million (26.3% of net sales and revenue) for the third quarter of fiscal 2005. Selling, general and administrative expenses were \$68.5 million (27.2% of net sales and revenue) for the first nine months of fiscal 2006 representing a decrease of \$1.1 million or 1.6% from \$69.6 million (26.8% of net sales and revenue) for the first nine months of fiscal 2005. The decrease in expenditures was primarily a result of lower advertising expenditures. These decreases were partially offset by an increase in payroll costs associated with higher commissions paid to sales personnel. In addition, we recognized stock based compensation expense in the third quarter and first nine months of fiscal 2006 of \$0.4 million and \$1.3 million, respectively as we adopted SFAS 123(R) during the first quarter of fiscal 2006.

Operating loss in the third quarter of fiscal 2006 was \$0.8 million (0.9% of net sales and revenue), a decrease of \$2.1 million (161.5%) from operating income of \$1.3 million (1.4% of net sales and revenue) for the third quarter of fiscal 2005. Operating income in the first nine months of fiscal 2006 was \$0.3 million (0.1% of net sales and revenue), a decrease of \$3.5 million (92.1%) from the \$3.8 million (1.5% of net sales and revenue) for the first nine months of fiscal 2005.

Investment income was \$341,000 and \$23,000 for the third quarter of fiscal 2006 and 2005, respectively. Investment income for the first nine months of fiscal 2006 was \$920,000 compared to \$155,000 for the first nine months of fiscal 2005. A majority of the increase in investment income results from higher levels of excess cash invested and higher interest rates during fiscal 2006 as compared to fiscal 2005.

Interest expense was \$0.6 million (0.6% of net sales and revenue) for the third quarter of fiscal 2006 compared to \$0.7 million (0.7% of net sales and revenue) for the third quarter of fiscal 2005. Interest expense was \$1.5 million (0.6% of net sales and revenue) for the first nine months of fiscal 2006 compared to \$1.9 million (0.7% of net sales and revenue) for the first nine months of fiscal 2005. Interest expense for the current year has been lowered

Edgar Filing: REX STORES CORP - Form 10-Q

primarily due to lower average borrowings on the line of credit.

23

We sold one property, classified in continuing operations, during the third quarter of fiscal 2006 for a gain of \$0.5 million. In addition, during the nine months ended October 31, 2006, we executed a sale and leaseback agreement for one owned property for a gain of approximately \$1.7 million. During the third quarter and nine months ended October 31, 2005, we sold one parcel of land attached to an owned property for a gain of approximately \$0.3 million.

Results for the third quarter and first nine months of fiscal 2006 include approximately \$2.8 million and \$4.2 million, respectively, from the sales of our investment in Colona SynFuel Limited Partnership, L.L.L.P. (Colona), which produces synthetic fuel. We sold our ownership interest in the Colona limited partnership through a series of three sales. We were to receive payments from the sales of our interests in Colona, on a quarterly basis through 2007, ranging from 74.25% to 82.5% of the federal income tax credits attributable to the interest sold subject to certain annual limitations and production levels. We have agreed to accept payments for calendar year 2006 production in 2007 after the 2006 "Annual Adjustment Amount" is published by the Internal Revenue Service. During the first quarter of fiscal 2006, we recorded approximately \$504,000 of income which relates to a payment received for 2005 production. The 2005 production payments were based upon estimated income tax credits per ton of coal produced. The \$504,000 payment was made to us after the Internal Revenue Service published the 2005 income tax credit per ton amount in April of 2006. During the first quarter of fiscal 2005, we recorded approximately \$448,000 of income which relates to a payment received for 2004 production. The 2004 production payments were based upon estimated income tax credits per ton of coal produced. The \$448,000 payment was made to us after the Internal Revenue Service published the 2004 income tax credit per ton amount in April of 2005. We recognized income of approximately \$121,000 in the third quarter of fiscal 2006 that related to production occurring in the quarter. We recognized income of approximately \$2,712,000 in the third quarter of fiscal 2006 that related to previously unrecognized income as a result of changes in our estimates of the phase out of Section 29/45K credits as a result of the price of oil.

Results for the third quarter and first nine months of fiscal 2006 include approximately \$2.4 million and \$3.3 million, respectively, from the sale of our investment in Somerset SynFuel L.P. (Somerset), which produces synthetic fuel. Effective October 1, 2005, we sold our entire ownership interest in Somerset, which owned two synthetic fuel facilities. We received \$1.2 million, net of commissions, at closing along with a secured contingent payment note that could provide additional investment income. We expect to receive quarterly payments through 2007 equal to 80% of the Section 29/45K tax credits attributable to the ownership interest sold, subject to production levels. During the first quarter of fiscal 2006, we recorded approximately \$58,000 of income which relates to 2005 production. The 2005 production payments were based upon estimated income tax credits per ton of coal produced. The \$58,000 was recognized after the Internal Revenue Service published the 2005 income tax credit per ton amount in April of 2006. We recognized income of approximately \$1,147,000 in the third quarter of fiscal 2006 that related to production occurring in the quarter. We recognized income of approximately \$1,249,000 in the third quarter of fiscal 2006 that related to previously unrecognized income as a result of changes in our estimates of the phase out of Section 29/45K credits as a result of the price of oil.

Edgar Filing: REX STORES CORP - Form 10-Q

Income from synthetic fuel investments for the third quarter and first nine months of fiscal 2006 also includes approximately \$0.6 million and \$1.1 million, respectively of pre-tax investment income from the sale of our entire membership interest in the limited liability company that owned a

24

synthetic fuel facility in Gillette, Wyoming. We received \$2.8 million at the time of sale on March 30, 2004 along with a secured contingent payment note that could provide additional investment income to us. The facility resumed commercial operations during the second quarter of fiscal 2005; as such, we received \$3.5 million as a one-time payment per the terms of the purchase agreement. In addition, we are eligible to receive \$1.50 per ton of "qualified production" produced by the facility and sold through 2007. Payments for qualified production occurring after January 31, 2006 through March 31, 2006 have been placed into escrow. Subject to certain conditions, we will receive any payments placed into escrow in calendar year 2007 after information necessary to calculate any phase out of Section 29/45K credits is published by the Department of Treasury. We recognized income of approximately \$635,000 in the third quarter of fiscal 2006 that related to previously unrecognized income as a result of changes in our estimates of the phase out of Section 29/45K credits as a result of the price of oil. During the third quarter of fiscal 2006, we entered into an agreement with the owners and operators of the synthetic fuel facility. Based on the terms of the agreement, including the timing of the receipt of payments, we may not be able to currently determine the likelihood of collecting payments related to production occurring after September 30, 2006. Thus, we cannot currently determine the impact and timing of the receipt of payments and income recognition related to production occurring after September 30, 2006.

As provided by the current Internal Revenue Code, the Code Section 29/45K tax credit program is expected to continue through December 31, 2007; however, recent increases in the price of oil could limit the amount of those credits or eliminate them altogether for 2006 and 2007. This possibility is due to a provision of Section 29/45K that provides that if the average wellhead price per barrel for unregulated domestic crude oil for the year (the "Annual Average Price") exceeds a certain threshold value (the "Threshold Price"), the Section 29/45K tax credits are subject to phase out. For calendar year 2005, the Threshold Price was \$53.20 per barrel and the Phase Out Price was \$66.78 per barrel. The Threshold Price and the Phase Out Price are adjusted annually as a result of inflation and are published by the Internal Revenue Service in April of the following year.

We cannot predict with absolute certainty the Annual Average Price for 2006 or beyond. Therefore, we cannot predict whether the price of oil will have a material effect on our synthetic fuel business after 2005. However, if during 2006 or 2007, oil prices remain at historically high levels or increase, such that the Annual Average Price exceeds the Threshold Price, our synthetic fuel business may be adversely affected for those years, and, depending on the magnitude of such increases in oil prices, the adverse affect for those years could be material and could have an impact on our synthetic fuel results of operations. Based upon the price of oil to date and considering the NYMEX futures market, we estimate the tax credits would be subject to approximately a 40% phase out as of October 31, 2006. Because synthetic fuel is not economical to produce absent the associated tax credits and the fact that we have no control or decision involvement with production levels, we cannot determine the impact of possible production reduction or elimination on our financial results.

Edgar Filing: REX STORES CORP - Form 10-Q

25

Below is a table summarizing the income from the sales, net of certain expenses, of our interests in synthetic fuel entities (in thousands):

	Three Months Ended October 31 -----	
	2006 ----	2005 ----
February 1, 1999 Colona sale.....	\$1,130	\$2,149
July 31, 2000 Colona sale.....	902	2,058
May 31, 2001 Colona sale.....	802	1,829
October 1, 2005 Somerset sale.....	2,396	1,178
March 30, 2004 Gillette sale.....	635	1,219
	-----	-----
	\$5,865	\$8,433
	=====	=====

Our effective tax rate was 32.1% and 24.1% for the third quarter of fiscal 2006 and 2005, respectively, after reflecting our share of federal income tax credits earned during 2005 by the limited partnerships under Section 29/45K of the Internal Revenue Code. Our effective tax rate was 34.5% and 18.4% for the first nine months of fiscal 2006 and 2005, respectively, after reflecting our share of federal income tax credits earned during 2005 by the limited partnerships under Section 29/45K of the Internal Revenue Code. As we no longer earn federal income tax credits from synthetic fuel production, we expect our tax rate in fiscal 2006 to be in the range of 32% to 40%.

During the quarter and nine months ended October 31, 2006 we closed or committed to close four and eight stores, respectively, that were classified as discontinued operations. As a result of these closings and certain other store closings from prior periods, we had income from discontinued operations, net of tax, of \$0.1 million for the third quarter of fiscal 2006, compared to a loss of \$0.2 million for the third quarter of fiscal 2005. We had a loss from discontinued operations, net of tax benefit, of \$0.2 million for the first nine months of fiscal 2006 compared to \$0.5 million for the first nine months of fiscal 2005.

We sold six properties, classified in discontinued operations, during the third quarter and first nine months of fiscal 2006 resulting in a gain, net of tax expense, of \$1.1 million.

As a result of the foregoing, net income for the third quarter of fiscal 2006 was \$4.8 million, a 30.4% decrease from \$6.9 million for the third quarter of fiscal 2005. Net income for the first nine months of fiscal 2006 was \$7.8 million, a 64.1% decrease from \$21.7 million for the first nine months of fiscal 2005.

LIQUIDITY AND CAPITAL RESOURCES

Net cash used in operating activities was approximately \$15.4 million for the first nine months of fiscal 2006, compared to \$5.5 million used in operating activities for the first nine months of fiscal 2005.

For the first nine months of fiscal 2006, cash was provided by net income of \$7.8 million, adjusted for the impact of \$8.7 million for gains on our installment sales of the limited partnership interests, non-cash items of \$2.4 million, which consisted of depreciation and amortization, stock based compensation expense, impairment charges, deferred income, gain on disposal of fixed assets, and the deferred income tax provision. In addition, accounts payable provided cash of \$2.2 million, primarily a result of the timing of vendor payments. The primary use of cash was an increase in inventory of \$18.7 million primarily due to seasonal fluctuations. The inventory decline from October 31, 2005 primarily results from lower television and audio levels.

For the first nine months of fiscal 2005, cash was provided by net income of \$21.7 million, adjusted for the impact of \$24.8 million for gains on our installment sales of the limited partnership interests, non-cash items of \$3.8 million, which consisted of depreciation and amortization, accounts receivable, deferred income, prepaid expenses and loss on disposal of fixed assets. In addition, accounts payable provided cash of \$6.1 million, primarily a result of changes in inventory levels. The primary use of cash was an increase in inventory of \$11.0 million primarily due to seasonal fluctuations. The other use of cash was a decrease in other current liabilities of \$1.2 million.

At October 31, 2006, working capital was \$105.7 million compared to \$88.0 million at January 31, 2006. This increase is primarily a result of inventory level fluctuations and synthetic fuel receivables. The ratio of current assets to current liabilities was 3.2 to 1 at October 31, 2006 and 2.9 to 1 at January 31, 2006.

Cash of \$8.2 million was provided by investing activities for the first nine months of fiscal 2006, compared to cash provided by investing activities of \$22.7 million for the first nine months of fiscal 2005. We paid \$5.0 million for an equity investment in Big River and received proceeds of \$9.3 million from the sale of real estate and fixed assets during the first nine months of fiscal 2006. The acquisition and resulting consolidation of Levelland/Hockley provided cash of \$1.7 million as Levelland Hockley's cash balance of \$13.2 million exceeded the purchase price of \$11.5 million. Additionally, during the first nine months of fiscal 2006, we received proceeds of \$2.7 million from installment sales of our ownership interests in synthetic fuel entities. We had capital expenditures of approximately \$0.4 million during the first nine months of fiscal 2006, primarily related to improvements at selected stores.

During the first nine months of fiscal 2005, we received proceeds of approximately \$23.6 million from installment sales of our ownership interest in the synthetic fuel entities. We had capital expenditures of approximately \$2.4 million during the first nine months of fiscal 2005, primarily related to the relocation of a store, the purchase of a store previously leased and improvements to a distribution center. We received proceeds of approximately \$1.5 million from the sale of a store previously closed and reported as discontinued operations and the sale of one parcel of land attached to an owned property.

Cash provided by financing activities totaled approximately \$1.8 million for the first nine months of fiscal 2006 compared to cash used in financing activities of \$20.6 million for the first nine months of fiscal 2005. Cash was provided by stock option activity of \$1.8 million. We also recorded a tax benefit of approximately \$1.0 million during the first nine months of fiscal 2006 from the exercise of non-qualified stock options as an increase in additional paid-in capital. Cash of \$3.1 million was used for scheduled payments of mortgage debt and cash of \$3.1 million was provided by new borrowings.

Cash used in financing activities totaled approximately \$20.6 million for the first nine months of fiscal 2005. Cash was provided by stock option activity of \$4.6 million. We also recorded a tax benefit of approximately \$1.8 million during the first nine months of fiscal 2005 from the exercise of non-qualified stock options as an increase in additional paid-in capital. Cash of \$2.7 million was used for scheduled payments of mortgage debt. Cash of approximately \$22.5 million was also used to acquire approximately 1.6 million shares of our common stock.

On November 28, 2005, we entered into a contingent agreement with Levelland/Hockley to purchase a convertible secured promissory note in the principal amount of \$5 million. The proceeds of the note will be used to capitalize Levelland/Hockley which intends to construct and, subsequently, operate an ethanol producing facility. The facility is expected to have a design capacity of 40 million gallons annually. The purchase of the note is expected to occur before December 31, 2006, subject to certain conditions.

On July 27, 2006, we entered into a contingent agreement with Levelland/Hockley to make an equity investment ranging from \$11.5 to \$18.0 million. We have funded \$11.5 million of this commitment. We may, subject to certain conditions, fund up to an additional \$6.5 million.

On March 17, 2006, we entered into a contingent agreement to purchase a note in the principal amount of \$14 million to be issued by Millennium Ethanol, LLC ("Millennium") which has commenced construction of an ethanol producing facility in Marion, South Dakota. The facility is expected to have a design capacity of 100 million gallons annually. We expect to fund the note in December 2006 as all conditions necessary for us to fund the note have been satisfied. We have obtained a \$14 million irrevocable letter of credit to secure our purchase obligation. The note purchase agreement provides us rights to purchase a minority equity interest in Millennium in exchange for the note. At October 31, 2006, the \$14 million letter of credit remained outstanding.

On May 26, 2006, we entered into a contingent agreement to invest \$24.9 million in One Earth Energy, LLC ("One Earth") which was organized to construct and, subsequently, operate an ethanol producing facility in Gibson City, Illinois. The facility is expected to have a design capacity of 100 million gallons annually. The equity investment is expected to occur before June 30, 2007, subject to One Earth obtaining additional financing and certain other conditions.

On June 8, 2006, we entered into a contingent agreement to invest \$16 million in Patriot Renewable Fuels, LLC ("Patriot") which has commenced construction of an ethanol producing facility in Annawon, Illinois. The facility is expected to have a design capacity of 100 million gallons annually. We funded this equity investment on December 4, 2006.

On October 1, 2006, we entered into a contingent agreement to invest \$20 million in Big River Resources, LLC ("Big River".) We have funded \$5 million of this investment in exchange for a 4.3% ownership interest. The remaining \$15 million investment is expected to occur in fiscal 2007, subject to certain conditions. Our final ownership percentage will be determined once Big River has obtained all funding.

We believe we have sufficient resources to fund these and other potential ethanol investments. However, depending upon the timing of these ethanol investments and future results of retail operations and synthetic fuel investments, we may incur increased borrowings, and a corresponding increase in interest expense, or seek other sources of financing.

In November 2006, we entered into 12 mortgage loan agreements to borrow approximately \$10.0 million. The loans are secured by real estate, payable over 10 years and bear interest at a fixed rate of 7.31%.

FORWARD-LOOKING STATEMENTS

This Form 10-Q contains or may contain forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. The words "believes", "estimates", "plans", "expects", "intends", "anticipates" and similar expressions as they relate to the Company or its management are intended to identify such forward-looking statements. Forward-looking statements are inherently subject to risks and uncertainties. These risks and uncertainties include among other things: the highly competitive nature of the consumer electronics retailing industry, changes in the national or regional economies, weather, the effects of terrorism or acts of war on consumer spending patterns, the availability of certain products, technological changes, new regulatory restrictions or tax law changes relating to the Company's synthetic fuel investments, the fluctuating amount of quarterly payments received by the Company with respect to sales of its partnership interests in synthetic fuel investments, the uncertain amount of synthetic fuel production and resulting income received from time to time from the Company's synthetic fuel investments, and the potential for Section 29/45K tax credits to phase out based on the price of crude oil adjusted for inflation. As it relates to ethanol investments, risks and uncertainties include among other things: the uncertainty of constructing plants on time and on budget and the volatility of corn, dried distiller grains, ethanol, gasoline and natural gas prices. Other factors that could cause actual results to differ materially from those in the forward-looking statements are set forth in Item 1A of the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2006 (File No. 001-09097).

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

No material changes since January 31, 2006.

ITEM 4. CONTROLS AND PROCEDURES

Our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures, as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief

Financial Officer concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and designed to ensure that information required to be disclosed in the reports that we file or submit under the Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

There were no changes in our internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

We acquired Levelland/Hockley County Ethanol, LLC on September 30, 2006. Levelland/Hockley is a development stage entity that plans to commence construction of an ethanol production facility in Levelland, Texas. It is a separate control environment. We have excluded this business from management's evaluation of internal control over financial reporting, as permitted by the SEC, for the quarter ended October 31, 2006.

PART II. OTHER INFORMATION

ITEM 1A. RISK FACTORS

During the quarter and nine months ended October 31, 2006, there have been no material changes to the risk factors discussed in our Annual Report on Form 10-K for the year ended January 31, 2006.

ITEM 6. EXHIBITS.

The following exhibits are filed with this report:

- 4(a) Fourth Amendment to Amended and Restated Loan Agreement dated as of August 18, 2006 among the Borrowers, REX Stores Corporation, the Lenders named therein, Bank of America, N.A. (f/k/a Fleet Retail Group, Inc.) as agent for the Lenders and KeyBank National Association as syndication agent
- 31 Rule 13a-14(a)/15d-14(a) Certifications
- 32 Section 1350 Certifications

Edgar Filing: REX STORES CORP - Form 10-Q

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

REX STORES CORPORATION
Registrant

SIGNATURE -----	TITLE -----	DATE ---
/s/ Stuart A. Rose ----- (Stuart A. Rose)	Chairman of the Board (Chief Executive Officer)	December
/s/ Douglas L. Bruggeman ----- (Douglas L. Bruggeman)	Vice President, Finance and Treasurer (Chief Financial Officer)	December