

REX STORES CORP
Form 10-Q
September 06, 2007

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended July 31, 2007

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 ()

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

At the close of business on September 5, 2007 the registrant had 10,416,825 shares of Common Stock, par value \$.01 per share, outstanding.

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REX STORES CORPORATION AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION**Item 1. Financial Statements****REX STORES CORPORATION AND SUBSIDIARIES
Consolidated Condensed Balance Sheets
Unaudited**

| | July 31, <u>2007</u> | January 31, <u>2007</u> | July 31, <u>2006</u> |
|--|-------------------------|----------------------------|-------------------------|
| | (In Thousands) | | |
| ASSETS | | | |
| CURRENT ASSETS: | | | |
| Cash and cash equivalents | \$ 90,293 | \$ 43,008 | \$ 5,481 |
| Accounts receivable, net | 3,128 | 1,975 | 4,149 |
| Synthetic fuel receivable | 3,851 | 8,838 | 3,171 |
| Note receivable, related party | - | - | 5,595 |
| Merchandise inventory, net | 84,256 | 70,078 | 123,349 |
| Prepaid expenses and other | 2,932 | 2,915 | 2,226 |
| Future income tax benefits | 6,562 | 9,192 | 9,354 |
| Total current assets | 191,022 | 136,006 | 153,325 |
| PROPERTY AND EQUIPMENT, NET | 78,575 | 122,769 | 121,994 |
| ASSETS HELD FOR SALE, NET | 1,064 | 2,009 | 2,822 |
| OTHER ASSETS | 23,595 | 18,986 | 10,580 |
| GOODWILL | 1,322 | 1,322 | - |
| FUTURE INCOME TAX BENEFITS | 23,533 | 26,245 | 29,228 |
| INVESTMENTS | 60,887 | 35,699 | - |
| RESTRICTED INVESTMENTS | 2,443 | 2,406 | 2,367 |
| Total assets | \$ 382,441 | \$ 345,442 | \$ 320,316 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | |
| CURRENT LIABILITIES: | | | |
| Current portion of long-term debt | \$ 2,183 | \$ 2,678 | \$ 2,476 |
| Deferred income <input type="checkbox"/> extended warranties | 15,085 | 15,641 | 15,401 |
| Accounts payable, trade | 42,923 | 23,254 | 31,557 |
| Current portion of deferred gain on sale and leaseback | 2,068 | 101 | 101 |
| Other current liabilities | 9,381 | 10,510 | 11,296 |
| Total current liabilities | 71,640 | 52,184 | 60,831 |
| LONG-TERM LIABILITIES: | | | |
| Long-term mortgage debt | 19,122 | 31,236 | 20,117 |
| Deferred income <input type="checkbox"/> extended warranties | 17,653 | 19,286 | 18,054 |
| Deferred gain on sale and leaseback | 6,163 | 504 | 554 |
| Other | 940 | - | - |
| Total long-term liabilities | 43,878 | 51,026 | 38,725 |
| MINORITY INTEREST IN CONSOLIDATED SUBSIDIARY | 11,764 | 11,443 | - |
| SHAREHOLDERS' EQUITY: | | | |
| Common stock | 298 | 295 | 295 |
| Paid-in capital | 143,214 | 139,337 | 138,238 |
| Retained earnings | 265,106 | 252,249 | 243,884 |
| Treasury stock | (163,176) | (161,092) | (161,657) |
| Accumulated other comprehensive income, net of tax | 9,717 | - | - |
| Total shareholders' equity | 255,159 | 230,789 | 220,760 |

REX STORES CORPORATION AND SUBSIDIARIES
Consolidated Condensed Statements Of Income
Unaudited

| | Three Months Ended | | Six Months Ended | |
|---|--|-----------------|------------------|-----------------|
| | <u>July 31,</u> | | <u>July 31,</u> | |
| | <u>2007</u> | <u>2006</u> | <u>2007</u> | <u>2006</u> |
| | (In Thousands, Except Per Share Amounts) | | | |
| Net sales and revenue | \$ 56,264 | \$ 63,583 | \$ 113,955 | \$ 129,572 |
| Cost of sales (Excluding depreciation) | 38,666 | 45,822 | 78,577 | 92,964 |
| Gross profit | 17,598 | 17,761 | 35,378 | 36,608 |
| Selling, general and administrative expenses | (17,013) | (17,645) | (33,834) | (35,936) |
| Interest income | 1,976 | 287 | 3,269 | 579 |
| Interest expense | (121) | (398) | (286) | (799) |
| Loss on early termination of debt | - | - | (651) | - |
| Gains on sale of real estate, net | 72 | 1,735 | 842 | 1,735 |
| Equity in income of unconsolidated ethanol affiliates | 412 | - | 1,522 | - |
| Income from synthetic fuel investments | 3,406 | 723 | 10,139 | 2,785 |
| Income from continuing operations before provision for income taxes and minority interest | 6,330 | 2,463 | 16,379 | 4,972 |
| Provision for income taxes | 2,578 | 895 | 6,454 | 1,845 |
| Minority interest | 54 | - | (41) | - |
| Income from continuing operations | 3,806 | 1,568 | 9,884 | 3,127 |
| Loss from discontinued operations, net of tax | (573) | (71) | (1,525) | (141) |
| Gain on disposal of discontinued operations, net of tax | 2,577 | - | 4,985 | - |
| NET INCOME | \$ 5,810 | \$ 1,497 | \$ 13,344 | \$ 2,986 |
| WEIGHTED AVERAGE SHARES | | | | |
| OUTSTANDING □ BASIC | 10,625 | 10,323 | 10,548 | 10,235 |
| Basic income per share from continuing operations | \$ 0.36 | \$ 0.15 | \$ 0.94 | \$ 0.30 |
| Basic loss per share from discontinued operations | (0.05) | - | (0.14) | (0.01) |
| Basic income per share on disposal of discontinued operations | 0.24 | - | 0.47 | - |
| BASIC NET INCOME PER SHARE | \$ 0.55 | \$ 0.15 | \$ 1.27 | \$ 0.29 |
| WEIGHTED AVERAGE SHARES | | | | |
| OUTSTANDING □ DILUTED | 11,989 | 11,575 | 11,911 | 11,607 |
| Diluted income per share from continuing operations | \$ 0.32 | \$ 0.13 | \$ 0.83 | \$ 0.27 |
| Diluted loss per share from discontinued operations | (0.05) | - | (0.13) | (0.01) |
| Diluted income per share on disposal of discontinued operations | 0.21 | - | 0.42 | - |
| DILUTED NET INCOME PER SHARE | \$ 0.48 | \$ 0.13 | \$ 1.12 | \$ 0.26 |

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

REX STORES CORPORATION AND SUBSIDIARIES
Consolidated Condensed Statements Of Shareholders' Equity
Unaudited

| | Common Shares | | Treasury | | Paid-in Capital | Retained Earnings | Accumulated Comprehensive Income | Total Shareholders' Equity |
|--|-------------------------|---------------|---------------|---------------|--------------------|----------------------|--|----------------------------------|
| | <u>Issued</u> Shares | <u>Amount</u> | <u>Shares</u> | <u>Amount</u> | | | | |
| | (In Thousands) | | | | | | | |
| Balance at January 31, 2007 | 29,513 | \$ 295 | 19,089 | \$ (161,092) | \$ 139,337 | \$ 252,249 | \$ - | \$ 230,789 |
| Net income | | | | | | 13,344 | | 13,344 |
| Cumulative effect of adopting FIN 48 | | | | | | (287) | | (287) |
| Treasury stock acquired | | | 195 | (3,780) | | | | (3,780) |
| Stock based compensation | | | | | 717 | | | 717 |
| Stock options exercised and related tax effects | 238 | 3 | (198) | 1,696 | 3,160 | | | 4,859 |
| Minority interest distribution | | | | | | (200) | | (200) |
| Unrealized holding gains, net of tax | | | | | | | 9,717 | 9,717 |
| Balance at July 31, 2007 | 29,751 | \$ 298 | 19,086 | \$ (163,176) | \$ 143,214 | \$ 265,106 | \$ 9,717 | \$ 255,159 |

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

REX STORES CORPORATION AND SUBSIDIARIES
Consolidated Condensed Statements Of Shareholders' Equity
Unaudited

| | Common Shares | | <u>Treasury</u> | Paid-in | Retained | Total | |
|--|----------------|---------------|-----------------|---------------|----------------|-----------------|----------------------|
| | <u>Issued</u> | | | | | | |
| | <u>Shares</u> | <u>Amount</u> | <u>Shares</u> | <u>Amount</u> | <u>Capital</u> | <u>Earnings</u> | <u>Shareholders'</u> |
| | (In Thousands) | | | | | | |
| Balance at January 31, 2006 | 29,390 | \$ 294 | 19,289 | \$ (162,762) | \$ 135,775 | \$ 240,898 | \$ 214,205 |
| Net income | | | | | | 2,986 | 2,986 |
| Stock based compensation | | | | | 934 | | 934 |
| Stock options exercised and related tax effects | 101 | 1 | (131) | 1,105 | 1,529 | | 2,635 |
| Balance at July 31, 2006 | 29,491 | \$ 295 | 19,158 | \$ (161,657) | \$ 138,238 | \$ 243,884 | \$ 220,760 |

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

REX STORES CORPORATION AND SUBSIDIARIES
Consolidated Condensed Statements Of Cash Flows
Unaudited

| | Six Months Ended | |
|---|------------------|-----------------|
| | <u>July 31</u> | |
| | <u>2007</u> | <u>2006</u> |
| | (In Thousands) | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$ 13,344 | \$ 2,986 |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Depreciation and amortization | 1,501 | 1,946 |
| Stock based compensation expense | 717 | 934 |
| Impairment charges | 65 | 85 |
| Capitalized interest | (911) | - |
| Income from equity method investments | (1,522) | - |
| Minority interest | 121 | - |
| Income from synthetic fuel investments | (10,139) | (2,785) |
| Gain on disposal of real estate and property and equipment | (8,992) | (1,704) |
| Dividends received from equity method investees | 525 | - |
| Deferred income | (2,772) | 486 |
| Excess tax benefits from stock option exercises | (19) | (24) |
| Deferred income tax | (616) | 810 |
| Changes in assets and liabilities: | | |
| Accounts receivable | (1,153) | (692) |
| Merchandise inventory | (14,178) | (25,978) |
| Prepaid expenses and other | (17) | 812 |
| Other long term assets | (9,609) | 53 |
| Accounts payable, trade | 16,318 | 12,428 |
| Other current liabilities | (476) | (2,291) |
| NET CASH USED IN OPERATING ACTIVITIES | (17,813) | (12,934) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Capital expenditures | (15,203) | (331) |
| Proceeds from sale of synthetic fuel investments | 15,126 | 1,294 |
| Purchase of note receivable | (3,000) | (5,595) |
| Proceeds from sale of real estate and property and equipment | 79,723 | 2,585 |
| Restricted investments | (37) | (49) |
| NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES | 76,609 | (2,096) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Payments of long-term debt | (17,593) | (1,258) |
| Proceeds from long-term debt | 4,984 | - |
| Stock options exercised | 4,859 | 1,649 |
| Treasury stock acquired | (3,780) | - |
| Excess tax benefits from stock option exercises | 19 | 24 |
| NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES | (11,511) | 415 |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 47,285 | (14,615) |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 43,008 | 20,096 |

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| | | | | |
|--|----|--------|----|-------|
| CASH AND CASH EQUIVALENTS, END OF PERIOD | \$ | 90,293 | \$ | 5,481 |
| Non cash investing activities □ Accrued capital expenditures | \$ | 3,351 | | - |

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

REX STORES CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
July 31, 2007

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. Financial information as of January 31, 2007 included in these financial statements has been derived from the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended January 31, 2007 (fiscal year 2006). 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, 2007. 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, its wholly and majority owned subsidiaries and all variable interest entities where the Company has been determined to be the primary beneficiary. During the second quarter of fiscal year 2007, the Company acquired additional membership units giving it a majority ownership in Levelland/Hockley County Ethanol, LLC (Levelland/Hockley). 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 year 2006. The Company includes the results of operations of Levelland/Hockley in its Consolidated Condensed Statement of Income on a delayed basis of one month.

Note 2. Reclassifications

The Company reclassified \$10.2 million and \$9.9 million of prepaid commissions from current and long term portion of deferred income on extended warranties to other assets at January 31, 2007 and July 31, 2006, respectively, to conform to current year presentation.

Note 3. Accounting Policies

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 2006 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, the fair value of investments classified as available for sale, income from synthetic fuel investments 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 for each major product group for the following periods:

| <u>Product Category</u> | Three Months Ended July 31, | | Six Months Ended July 31, | |
|-------------------------|--------------------------------|-------------|------------------------------|-------------|
| | <u>2007</u> | <u>2006</u> | <u>2007</u> | <u>2006</u> |
| Televisions | 48.5% | 47.5% | 50.6% | 52.1% |
| Appliances | 35.4 | 33.9 | 32.4 | 28.4 |
| Audio | 4.0 | 6.9 | 4.9 | 7.7 |
| Video | 2.5 | 3.8 | 2.6 | 3.7 |
| Extended warranties | 5.7 | 3.7 | 5.2 | 3.5 |
| Other | 3.9 | 4.2 | 4.3 | 4.6 |
| | 100.0% | 100.0% | 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's policy is to exclude taxes assessed by a governmental authority that are directly imposed on a revenue-producing transaction from revenue on a net reporting basis.

The Company recognizes income from synthetic fuel partnership sales as production is completed and collectibility of receipts is reasonably assured. The Company is paid for actual tax credits earned as the synthetic fuel is produced with the exception of production at the Pine Mountain (Gillette) facility. 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 12 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.

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 of \$286,000 for the six months ended July 31, 2007 is net of approximately \$911,000 of interest capitalized. No interest was capitalized in the six months ended July 31, 2006. Cash paid for interest for the six months ended July 31, 2007 and 2006 was approximately \$1,228,000 and \$966,000, 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 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 \$7.1 million and \$0.1 million for the six months ended July 31, 2007 and 2006, respectively. See Note 14 for a discussion of the adoption of FIN 48.

Investments in debt securities are considered "held to maturity", "available for sale", or "trading securities" under 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 balance sheets. The fair values of 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 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 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, which are principally marketable debt securities of a federal government agency, are stated at cost plus accrued interest, which approximates market. Restricted investments at July 31, 2007 and 2006 are required by two states to cover possible future claims under product service contracts. In accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS 115"), the Company has classified the investments as held-to-maturity. The investments had maturity dates of less than one year at July 31, 2007 and 2006. The Company has the intent and ability to hold these securities to maturity.

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, 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, it is required to re-evaluate whether it 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 7 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. 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.

Recently Issued Accounting Standards

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements", (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. This statement does not require any new fair value measurements; rather, it applies to other accounting pronouncements that require or permit fair value measurements. The provisions of this statement are to be applied prospectively as of the beginning of the fiscal year in which this statement initially applies, with any transition adjustment recognized as a cumulative-effect adjustment to the opening balance of retained earnings. The provisions of SFAS 157 are effective for fiscal years beginning after November 15, 2007. The Company anticipates adopting this standard as of February 1, 2008. The Company has not determined the effect, if any, the adoption of this statement will have on its financial condition or results of operations.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities", (SFAS 159). SFAS 159 permits all entities to choose to measure eligible items at fair value at specified election dates. A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. This statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company has not determined the effect, if any, the adoption of this statement will have on its financial condition or results of operations.

Note 4. Accounting Changes

During the fourth quarter of fiscal year 2006, the Company changed its method of accounting for the inventory of an acquired subsidiary, Kelly & Cohen Appliances, Inc. (K&C). K&C inventory was historically valued at the lower of cost or market using the last-in, first-out (LIFO) method. The Company changed its method of accounting for the inventory of K&C from the LIFO method to the first-in, first-out (FIFO) method. The Company believes the FIFO method is preferable because it conforms all of the Company's inventory to a single costing method and it is comparable with its major competitors. In accordance with SFAS 154, "Accounting Changes and Error Corrections" (SFAS 154), the change from the LIFO method has been applied retrospectively.

However, the change to the FIFO method for the K&C inventory did not result in either a current period or retrospective adjustment to any historical consolidated balance sheets, statements of income or statements of cash flow as the lower of cost or market inventory value using the LIFO method has been equivalent to the lower of cost or market inventory value using the FIFO method for all periods presented.

Note 5. Comprehensive Income

Comprehensive income includes net income and unrecognized gains on securities classified as available for sale (net of the related tax effects), and are reported separately in shareholders' equity. The components of comprehensive income are as follows (amounts in thousands):

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|------------------|------------------|------------------|
| | July 31, 2007 | July 31, 2006 | July 31, 2007 | July 31, 2006 |
| Net income | \$ 5,810 | \$ 1,497 | \$ 13,344 | \$ 2,986 |
| Unrealized holding gains on available for sale securities (net of \$5,956 of tax) | 9,717 | - | 9,717 | - |
| Total comprehensive income | \$ 15,527 | \$ 1,497 | \$ 23,061 | \$ 2,986 |

Note 6. Sale and Leaseback Transaction and Other Leases

On April 30, 2007, the Company completed a transaction for the sale of 86 of its current and former store locations to KLAC REX, LLC (["Klac"]), formerly referred to as Coventry Real Estate Investments, LLC (["Coventry"]) for \$74.5 million in cash, before selling expenses. The Company also entered into leases to leaseback 40 of the properties from Klac for initial lease terms expiring January 31, 2010, with renewal options for up to 15 additional years. Either the Company or Klac may terminate a lease after the initial six months of the initial lease term on 28 of the leases, one of which was terminated in the second quarter of fiscal year 2007. The Company also entered into license agreements with Klac for 15 of the properties that allowed the Company to occupy the properties for up to 90 days rent free. Upon the expiration of the license period, the Company vacated the 15 properties.

A pre-tax gain of \$3.2 million (net of expenses and losses) resulted from this sale in the first quarter of fiscal year 2007. Of this gain, \$2.2 million was classified as discontinued operations and the remaining \$1.0 million was classified as continuing operations. The Company also deferred \$11.6 million, which represented the present value of the minimum lease payments and a portion of the gain associated with stores that the Company had continuing involvement with, as defined in SFAS 98, ["Accounting for Leases"]. The deferred gain will be amortized as a reduction to lease expense over the lease or license periods or recognized as gain on disposal at the end of the lease or license period. Approximately \$3.9 million of the deferred gain was recognized during the second quarter of fiscal

2007. Of this gain \$3.3 million was classified as discontinued operations and the remaining \$0.6 million was classified as continuing operations. The leases have been accounted for as operating leases. Future minimum annual rentals on the properties leased back are \$2.0 million, \$4.0 million and \$4.4 million for the fiscal years ended January 31, 2008, 2009 and 2010, respectively, subject to earlier termination of individual leases.

The following table summarizes the components of the sale and leaseback transaction (amounts in thousands):

| Property Category | Number of Properties | Deferred Gain | Recognized Gain (Loss) |
|---|----------------------|---------------|------------------------|
| Vacated | 47 | \$ - | \$ 5,833 |
| Leased until January 31, 2010 | 12 | 4,087 | (68) |
| Leased until January 31, 2010 (6 month kickout clause) | 27 | 3,590 | 1,363 |
| Total | 86 | \$ 7,677 | \$ 7,128 |

In addition to the leaseback transaction described above, the Company is committed under operating leases for certain retail store locations. The lease agreements are for varying terms through 2011 and contain renewal options for additional periods. Real estate taxes, insurance and maintenance costs are generally paid by the Company. Contingent rentals based on sales volume are not significant. Certain leases contain scheduled rent increases and rent expense is recognized on a straight-line basis over the term of the leases.

The following table is a summary of rental activity under operating leases (amounts in thousands):

| Years Ended | Minimum Rentals | Gain Amortization | Sublease Income | Total |
|-------------------------------|-----------------|-------------------|-----------------|----------|
| January 31 | | | | |
| Remainder of January 31, 2008 | \$ 3,990 | \$ (1,048) | \$ (110) | \$ 2,832 |
| 2009 | 7,044 | (2,068) | (215) | 4,761 |
| 2010 | 6,034 | (2,068) | (135) | 3,831 |
| 2011 | 495 | (637) | (70) | (212) |
| 2012 | 206 | (637) | (5) | (436) |
| Thereafter | - | (1,773) | - | (1,773) |
| Total | \$ 17,769 | \$ (8,231) | \$ (535) | \$ 9,003 |

Note 7. 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 been included in the consolidated financial statements subsequent to the acquisition date. The aggregate purchase price was \$11.5 million, all of which was cash.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition:

(In thousands)

| | |
|-------------------------------|-----------|
| Cash | \$ 13,165 |
| Accrued interest receivable | 24 |
| Property, plant and equipment | 595 |
| Prepaid loan fees | 3,200 |
| Deposits | 5,220 |
| Goodwill | 1,322 |
| Total assets acquired | 23,526 |
| Current liabilities | (577) |
| Minority interest | (11,449) |
| Net purchase price | \$ 11,500 |

Prepaid loan fees 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 has commenced construction of an ethanol production facility in Levelland, Texas, which will have a design capacity of 40 million gallons of ethanol annually.

Effective July 1, 2007 the Company converted its \$5.0 million convertible secured promissory note, which increased its ownership interest in Levelland/Hockley to 56%. There was a \$200,000 premium over book value related to the conversion; the premium was recorded as a distribution to minority interest holders on the statement of shareholders' equity.

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 the period 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 the period presented.

The pro forma financial information for the period presented includes adjustments to interest income and expense and related income tax effects (in thousands, except per share data):

| | Quarter Ended July 31, 2006 | Six Months July 31, 2006 |
|------------------------------|--------------------------------|-----------------------------|
| Net sales and revenue | \$ 63,583 | \$ 129,572 |
| Net income | \$ 1,399 | \$ 2,789 |
| Basic net income per share | \$ 0.14 | \$ 0.27 |
| Diluted net income per share | \$ 0.12 | \$ 0.24 |

Note 8. Other Assets

The components of other assets at July 31, 2007, January 31, 2007 and July 31, 2006 are as follows (amounts in thousands):

| | July 31, <u>2007</u> | January 31, <u>2007</u> | July 31, <u>2006</u> |
|---------------------------|-------------------------|----------------------------|-------------------------|
| Prepaid loan fees | \$ 4,166 | \$ 4,377 | \$ 619 |
| Prepaid commissions | 9,557 | 10,234 | 9,873 |
| Advance equity investment | 10,000 | 5,000 | - |
| Other | 121 | 155 | 223 |
| Total | 23,844 | 19,766 | 10,715 |
| Less current portion | 249 | 780 | 135 |
| Long term | \$ 23,595 | \$ 18,986 | \$ 10,580 |

Advance equity investment at July 31, 2007, represents a payment made to Big River Resources, LLC in July 2007 and will be effective August 1, 2007; this increased the Company's ownership percentage in Big River from 6.9% to 9.8%. Advance equity investment at January 31, 2007, represents a payment made to Big River Resources, LLC in January 2007 and was effective February 1, 2007; this increased the Company's ownership percentage in Big River from 4.3% to 6.9%. Prepaid loan fees represent amounts paid to obtain mortgage debt, borrowings under the Company's line of credit and an ethanol construction loan. Such amounts are amortized as interest expense.

Future amortization expense of prepaid loan fees is as follows (amounts in thousands):

Year Ended

| | | |
|-------------------------------|----|-------|
| Remainder of January 31, 2008 | \$ | 439 |
| January 31, 2009 | | 894 |
| January 31, 2010 | | 785 |
| January 31, 2011 | | 640 |
| January 31, 2012 | | 586 |
| Thereafter | | 822 |
| Total | \$ | 4,166 |

Prepaid commissions represent sales commissions paid in connection with extended warranties sold by the Company's sales staff. Such amounts are capitalized and amortized ratably over the life of the extended warranty plan sold.

Future amortization of prepaid commissions is as follows (amounts in thousands):

Year Ended

| | | |
|-------------------------------|----|-------|
| Remainder of January 31, 2008 | \$ | 2,145 |
| January 31, 2009 | | 3,698 |
| January 31, 2010 | | 2,155 |
| January 31, 2011 | | 1,083 |
| January 31, 2012 | | 441 |
| Thereafter | | 35 |
| Total | \$ | 9,557 |

Note 9. Long Term Debt

The Company borrowed \$5.0 million by obtaining one mortgage loan secured by five properties during the first six months of fiscal year 2007. The mortgage loan bears interest at a variable rate of LIBOR plus 1.85% (presently 7.2%) and is payable over 5 years.

The Company paid off 29 mortgage loans that had a principal balance of \$16.5 million in connection with the sale and leaseback transaction (see Note 6) and other real estate sales. In addition, the Company incurred prepayment penalties and the write off of prepaid loan fees, totaling \$0.7 million, classified as loss on early termination of debt.

Note 10. 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.

No options have been granted since fiscal year 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 the fiscal year ended January 31, 2005: risk-free interest rate of 4.7%, expected volatility of 65.4% and a weighted average stock option life of nine years for all grants.

The total intrinsic value of options exercised during the six months ended July 31, 2007 and 2006 was approximately \$4.4 million and \$2.3 million, respectively, resulting in tax deductions of approximately \$1.7 million and \$1.0 million, respectively. The following table summarizes options exercised and canceled or expired during the six months ended July 31, 2007:

| | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value (in thousands) |
|---------------------------------|-----------|---------------------------------|---|--|
| Outstanding at January 31, 2007 | 4,336,893 | \$ 8.18 | | |
| Exercised | (436,596) | \$ 7.18 | | |
| Forfeited | (48,200) | \$12.67 | | |
| Outstanding at July 31, 2007 | 3,852,097 | \$ 8.23 | 3.4 | \$ 46,645 |
| Exercisable at July 31, 2007 | 3,634,778 | \$ 7.96 | 3.2 | \$ 44,981 |

At July 31, 2007, there was approximately \$2.1 million (pre-tax) of unrecognized compensation cost related to nonvested stock options, which is expected to be recognized over a weighted average period of 1.6 years.

Note 11. Income Per Share from Continuing Operations

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

| | Three Months Ended <u>July 31, 2007</u> | | | Six Months Ended <u>July 31, 2007</u> | | |
|---|--|---------------|------------------|--|---------------|------------------|
| | <u>Income</u> | <u>Shares</u> | <u>Per Share</u> | <u>Income</u> | <u>Shares</u> | <u>Per Share</u> |
| Basic income per share from continuing operations | \$ 3,806 | 10,625 | \$ 0.36 | \$ 9,884 | 10,548 | \$ 0.94 |
| Effect of stock options | | 1,364 | | | 1,363 | |
| Diluted income per share from continuing operations | \$ 3,806 | 11,989 | \$ 0.32 | \$ 9,884 | 11,911 | \$ 0.83 |

| | Three Months Ended <u>July 31, 2006</u> | | | Six Months Ended <u>July 31, 2006</u> | | |
|---|--|---------------|----------------------|--|---------------|----------------------|
| | <u>Income</u> | <u>Shares</u> | <u>Per Share</u> | <u>Income</u> | <u>Shares</u> | <u>Per Share</u> |
| Basic income per share from continuing operations | \$ 1,568 | 10,323 | \$ 0.15 | \$ 3,127 | 10,235 | \$ 0.30 |
| Effect of stock options | | 1,252 | | | 1,372 | |
| Diluted income per share from continuing operations | \$ 1,568 | 11,575 | \$ 0.13 | \$ 3,127 | 11,607 | \$ 0.27 |

For the three months ended July 31, 2007 and 2006, a total of 117,719 shares and 488,874 shares, respectively, and for the six months ended July 31, 2007 and 2006, a total of 217,319 shares and 488,874 shares, respectively, subject to outstanding options were not included in the common equivalent shares outstanding calculation as the effect from these shares is antidilutive.

Note 12. Synthetic Fuel

Income from continuing operations for the second quarter and first six months of fiscal year 2007 includes approximately \$2.4 million and \$7.3 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 expects 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. During the first quarter of fiscal year 2007, the Company recorded approximately \$909,000 of income which relates to 2006 production and a change in the estimated Section 29/45K phase out. The 2006 production payments were based upon estimated income tax credits per ton of coal produced. The payment was made to the Company after the Internal Revenue Service published the 2006 income tax credit per ton amount in April of 2007. During the first quarter of fiscal year 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.

Income from continuing operations for the second quarter and first six months of fiscal year 2007 includes approximately \$1.0 million and \$2.9 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.

The Company sold its entire membership interest in the limited liability company that owned a synthetic fuel facility in Gillette, Wyoming on March 30, 2004. The Company received \$2.8 million

at the time of sale 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. The plant was subsequently sold and during the third quarter of fiscal year 2006, the Company modified its agreement with the owners and operators of the synthetic fuel facility. Based on the terms of the modified agreement, the Company currently is not able to determine the likelihood of collecting payments related to production occurring after September 30, 2006. Thus, the Company cannot currently determine the impact and timing of income recognition, if any, 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 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 2006, the Threshold Price was \$55.06 per barrel and the Phase Out Price was \$69.12 per barrel, resulting in a phase out of 33% for calendar year 2006. 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 2007. Therefore, it cannot predict whether the price of oil will have a material effect on its synthetic fuel business after 2006. However, if during 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 2007, and, depending on the magnitude of such increases in oil prices, the adverse effect for 2007 could be material and could have an impact on the Company's synthetic fuel income. Based upon the price of oil to date and considering the NYMEX futures market, the Company estimates the tax credits would be subject to a 25% phase out as of July 31, 2007. 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 | | Six Months Ended | |
|-------------------------------|--------------------|-------------|------------------|-------------|
| | <u>July 31,</u> | | <u>July 31,</u> | |
| | <u>2007</u> | <u>2006</u> | <u>2007</u> | <u>2006</u> |
| February 1, 1999 Colona sale | \$ 949 | \$ 103 | \$ 2,894 | \$ 362 |
| July 31, 2000 Colona sale | 757 | 82 | 2,309 | 556 |
| May 31, 2001 Colona sale | 673 | 73 | 2,052 | 494 |
| October 1, 2005 Somerset sale | 1,027 | 465 | 2,884 | 950 |
| March 30, 2004 Gillette sale | - | - | - | 423 |
| | \$ 3,406 | \$ 723 | \$ 10,139 | \$ 2,785 |

Note 13. Investments

The following tables summarize investments at July 31, 2007, January 31, 2007 and July 31, 2006 (amounts in thousands):

Debt Securities July 31, 2007

| Investment | Coupon Rate | Maturity | Classification | Fair Market Value | Carrying Amount |
|--|-------------|-----------|--------------------|-------------------|-----------------|
| Federal National Mortgage Association Note | 5.17% | 8/15/2007 | Held to Maturity | \$ 1,511 | \$ 1,511 |
| Millennium Ethanol, LLC Convertible Note | 15.60% | 4/1/2015 | Available for Sale | 29,675 | 29,675 |
| One Earth Energy, LLC Promissory Note | 9.00% | 12/1/2007 | Held to Maturity | 3,000 | 3,000 |
| Total Debt Securities | | | | \$ 34,186 | \$ 34,186 |

Debt Securities January 31, 2007

| Investment | Coupon Rate | Maturity | Classification | Fair Market Value | Carrying Amount |
|--|-------------|-----------|--------------------|-------------------|-----------------|
| Federal National Mortgage Association Note | 5.04% | 2/16/2007 | Held to Maturity | \$ 1,473 | \$ 1,473 |
| Millennium Ethanol, LLC Convertible Note | 15.60% | 4/1/2015 | Available for Sale | 14,000 | 14,000 |
| Total Debt Securities | | | | \$ 15,473 | \$ 15,473 |

Debt Securities July 31, 2006

| Investment | Coupon Rate | Maturity | Classification | Fair Market Value | Carrying Amount |
|--------------------------------------|-------------|----------|------------------|-------------------|-----------------|
| Federal Home Loan Mortgage Corp Note | 4.94% | 8/8/2006 | Held to Maturity | \$ 1,434 | \$ 1,434 |
| Total Debt Securities | | | | \$ 1,434 | \$ 1,434 |

Unrealized holding gains were \$15.7 million (pre tax) in fiscal year 2007 compared to no unrealized holding gains or losses in fiscal year 2006.

On March 17, 2006, the Company entered into an 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 funded the note on December 18, 2006. The note agreement provides the Company rights to purchase a minority equity interest in Millennium in exchange for the note. Monthly payments of principal and interest are scheduled to begin on the earlier of the date the ethanol plant is certified ready for production or April 1, 2008. Accrued interest receivable was approximately \$1.4 million at July 31, 2007. Pursuant to the note, funded in December 2006, the Company's interest will convert to 33.92% of the membership interests in Millennium. See Note 18 for a discussion of a subsequent event related to the Millennium note.

On May 31, 2007, the Company entered into an agreement with U.S. BioEnergy Corporation and Millennium Ethanol, LLC ("Millennium") for the conversion of the Company's \$14 Million Convertible Secured Promissory Note including accrued interest, and Related Purchase Rights ("the Note") issued by Millennium.

US BioEnergy Corporation, has agreed to acquire Millennium for approximately \$135 million (before certain expenses) payable in US BioEnergy common stock, cash, or any combination thereof at US BioEnergy's election; provided that, in no event will US BioEnergy issue more than 11.5 million shares of stock in the transaction. If US BioEnergy would otherwise be required to issue more than 11.5 million shares of stock to provide approximately \$135 million of value, US BioEnergy will pay the balance of the consideration in cash. If, however, the closing price of US BioEnergy's common stock for the ten trading days immediately prior to the Special Meeting of Millennium's members to approve the merger is greater than or equal to \$15.88 per share, the aggregate consideration payable to Millennium's members will be 8.5 million shares of US BioEnergy common stock. (See note 18 for further discussion.)

The Company has approximately \$932,000 at July 31, 2007, January 31, 2007 and July 31, 2006 on deposit with the Florida Department of Financial Services to secure its obligation to fulfill future obligations related to extended warranty contracts sold in the state of Florida. The deposits earned 4.3%, 5.7% and 3.5% at July 31, 2007, January 31, 2007 and July 31, 2006, respectively.

The following table summarizes equity method investments at July 31, 2007 (amounts in thousands):

| Entity | Ownership Percentage | Carrying Amount | Initial Investment |
|------------------------------|----------------------|-----------------|--------------------|
| Big River Resources, LLC | 6.9% | \$ 11,352 | \$ 10,000 |
| Patriot Renewable Fuels, LLC | 23.3% | 16,860 | 16,000 |
| Total Equity Securities | | \$ 28,212 | \$ 26,000 |

The following table summarizes equity method investments at January 31, 2007 (amounts in thousands):

| Entity | Ownership Percentage | Carrying Amount | Initial Investment |
|------------------------------|----------------------|-----------------|--------------------|
| Big River Resources, LLC | 4.3% | \$ 5,499 | \$ 5,000 |
| Patriot Renewable Fuels, LLC | 23.3% | 16,200 | 16,000 |
| Total Equity Securities | | \$ 21,699 | \$ 21,000 |

On October 1, 2006, the Company entered into an agreement to invest \$20 million in Big River Resources, LLC ("Big River"). 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. The Company has funded \$10 million of this investment in exchange for a 6.9% ownership interest. On July 31, 2007 the Company advanced an additional \$10 million to Big River (see Note 8). This investment was effective August 1, 2007 and increased the Company's ownership percentage from 6.9% to 9.8%. During the first six months of fiscal year 2007, the Company recorded income of \$1,379,000 as its share of earnings from Big River.

On June 8, 2006, the Company entered into an 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 Company funded this investment on December 4, 2006 in exchange for a 23.3% ownership interest. Patriot is a development stage enterprise; the Company has capitalized interest of \$503,000 at July 31, 2007 as Patriot is constructing its ethanol plant. During the first six months of fiscal year 2007, the Company recorded income of \$143,000 as its share of earnings from Patriot.

Undistributed earnings of equity method investees totaled approximately \$1.5 million at July 31, 2007.

Note 14. Income Taxes

The effective tax rate on consolidated pre-tax income was 39.4% for the six months ended July 31, 2007, 33.1% for the year ended January 31, 2007 and 37.1% for the six months ended July 31, 2006. An adjustment for recognizing the benefit of Section 29/45K tax credits of 1.4% is reflected in the effective rate for the year ended January 31, 2007. The provision for state taxes is approximately 4.0% and 3.8% for the six months ended July 31, 2007 and 2006, respectively. The provision for state taxes is approximately (0.4)% for the year ended January 31, 2007.

The Company files a U.S. federal income tax return and income tax returns in various states. In general, the Company is no longer subject to U.S. federal, state or local income tax examinations by tax authorities for fiscal years ended before January 31, 2002.

The Company adopted the provisions of FIN 48 on February 1, 2007. As a result of the adoption of FIN 48, the Company recorded a \$287,000 decrease to retained earnings. As of February 1, 2007, total unrecognized tax benefits were \$639,000, and accrued penalties and interest were \$301,000. If the Company were to prevail on all unrecognized tax benefits recorded, approximately \$639,000 of the reserve would benefit the effective tax rate. There were no unrecognized tax benefits that represented temporary differences. In addition, the impact of penalties and interest would also benefit the effective tax rate. Interest and penalties associated with unrecognized tax benefits are recorded within income tax expense.

On a quarterly and annual basis, the Company accrues for the effects of open uncertain tax positions and the related potential penalties and interest. There were no material adjustments to the recorded liability for unrecognized tax benefits during the first six months of fiscal year 2007, other than those made in connection with the adoption of FIN 48 that are described above.

It is reasonably possible that the amount of the unrecognized tax benefit with respect to certain unrecognized tax positions will increase or decrease during the next 12 months; however, the Company does not expect the change to have a material effect on results of operations or financial position.

Note 15. Discontinued Operations and Assets Held for Sale

During the first six months of fiscal year 2007, the Company closed 46 stores in which the Company vacated the market or will not have a further continuing involvement with the related property. These stores, and certain other stores closed in previous periods were classified as discontinued operations for all periods presented. One closed store is classified as held for sale. The net assets of this store at July 31, 2007 were approximately \$1.1 million. The Company expects to sell the fixed assets related to this store 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 | | Six Months Ended | |
|----------------------------|--------------------|-------------|------------------|-------------|
| | <u>July 31,</u> | | <u>July 31,</u> | |
| | <u>2007</u> | <u>2006</u> | <u>2007</u> | <u>2006</u> |
| | (In Thousands) | | | |
| Net sales and revenue | \$ 4,837 | \$ 18,727 | \$ 16,919 | \$ 39,189 |
| Cost of sales | 4,568 | 14,071 | 14,350 | 29,409 |
| Loss before income taxes | (882) | (109) | (2,346) | (216) |
| Benefit for income taxes | 309 | 38 | 821 | 75 |
| Gain on disposal | 3,965 | - | 7,669 | - |
| Provision for income taxes | (1,388) | - | (2,684) | - |
| Net income (loss) | \$ 2,004 | \$ (71) | \$ 3,460 | \$ (141) |

Note 16. Commitments

On June 15, 2007, the Company entered into a contingent agreement to subscribe for a minimum of \$35.1 million and a maximum of \$62.4 million of membership units of One Earth Energy, LLC (One Earth) in a registered offering. This replaced the Company's prior commitment to fund \$24.9 million in One Earth. One Earth intends to commence construction, beginning in 2007, of an ethanol manufacturing facility with an annual production capacity of 100 million gallons in Gibson City, Illinois. The Company's commitment will enable it to secure a majority ownership interest in One Earth.

In addition, the Company has entered into a conditional agreement with One Earth to fund up to an additional \$6.0 million in interim financing in the form of secured debt, bearing an interest rate of 9% per annum. As of July 31, 2007, the Company has funded \$3.0 million of the interim financing.

In June 2006, Levelland/Hockley entered into an agreement with a designer/builder for the construction of Levelland's ethanol plant. The designer/builder is responsible for all engineering, labor, materials and equipment to design, construct, startup and achieve guaranteed performance criteria of the plant. The contract price is approximately \$58.4 million, of which \$17.4 million has been spent through July 31, 2007.

On July 25, 2002, Levelland/Hockley entered into an agreement with RIO Technical Services, Inc., (RIO) regarding the planning, financing, design and construction of Levelland's ethanol plant. RIO is a related party, as certain officers of RIO own equity interests in Levelland/Hockley. The Company estimates that fees for these services will be approximately \$3.0 million, of which approximately \$1.0 million has been spent through July 31, 2007.

In addition, Levelland/Hockley paid RIO approximately \$3.6 million as compensation for RIO's evaluation and assistance for Levelland/Hockley to obtain financing. These costs are recorded as either prepaid loan fees or equity issuance costs.

Note 17. Segment Reporting

The Company has two reportable segments, consumer electronics and appliance retailing (□retail□) and alternative energy. The Company evaluates the performance of each reportable segment based on segment profit. Segment profit excludes income taxes, interest expense, discontinued operations, indirect interest income and certain other items that are included in net income determined in accordance with accounting principles generally accepted in the United States of America.

Amounts in the other category below include business activities that are not separately reportable and income from synthetic fuel investments (amounts in thousands):

| | Quarters Ended July 31, | | Six Months Ended July 31, | |
|---|-------------------------|-------------|---------------------------|-------------|
| | <u>2007</u> | <u>2006</u> | <u>2007</u> | <u>2006</u> |
| Net sales and revenue: | | | | |
| Retail | \$ 56,264 | \$ 63,583 | \$ 113,955 | \$ 129,572 |
| Alternative energy | - | - | - | - |
| Total net sales and revenues | \$ 56,264 | \$ 63,583 | \$ 113,955 | \$ 129,572 |
| Segment profit: | | | | |
| Retail segment profit | \$ 1,951 | \$ 2,584 | \$ 4,702 | \$ 3,700 |
| Alternative energy segment profit (loss) | 746 | (379) | 2,112 | (402) |
| Corporate expense | (865) | (354) | (1,476) | (889) |
| Interest expense | (121) | (398) | (937) | (799) |
| Interest income | 1,213 | 287 | 1,839 | 577 |
| Income from synthetic fuel investments | 3,406 | 723 | 10,139 | 2,785 |
| Income from continuing operations before income taxes | \$ 6,330 | \$ 2,463 | \$ 16,379 | \$ 4,972 |
| | July 31, | January 31, | July 31, | |
| | 2007 | 2007 | 2006 | |
| Assets: | | | | |
| Retail | \$ 243,882 | \$ 233,666 | \$ 272,897 | |
| Alternative energy | 104,613 | 67,653 | 5,666 | |
| Corporate | 33,946 | 44,123 | 41,753 | |
| Total assets | \$ 382,441 | \$ 345,442 | \$ 320,316 | |

Certain corporate costs and expenses, including information technology, employee benefits and other shared services are allocated to the business segments. The allocations are generally amounts agreed upon by management, which may differ from amounts that would be incurred if such services were purchased separately by the business segment. Corporate assets are primarily synthetic fuel accounts receivable and deferred income tax benefits.

Cash, except for cash held by Levelland/Hockley, is considered to be fungible and available for both corporate and segment use dependent on liquidity requirements. Cash of approximately \$1.8

million held by Levelland/Hockley will be used primarily to fund the construction of a 40 million gallon ethanol plant and to provide working capital until the plant commences operations.

Note 18. Subsequent Events

On August 21, 2007, the Company entered into a conditional agreement with Levelland/Hockley to fund up to an additional \$2.1 million in the form of either subordinated debt or equity.

On August 29, 2007, US BioEnergy Corporation completed the acquisition of Millennium Ethanol, LLC (["Millennium"]). In connection with the acquisition, the Company received 3,693,858 shares of US BioEnergy Common Stock and approximately \$4.8 million of cash as total consideration for its interest in Millennium Ethanol, LLC based upon the conversion of the Company's \$14 million convertible secured promissory Note, accrued interest and related purchase rights.

On August 29, 2007, KLAC REX, LLC (["Klac"]) notified the Company that Klac was exercising its right to terminate nine leases with the Company. The Company must vacate the properties no later than October 30, 2007. At July 31, 2007, the Company operated a retail store at each of these locations.

On September 5, 2007, the Company sold seven properties for approximately \$10.4 million. These properties had a book value of approximately \$6.1 million and related notes payable balances of approximately \$3.1 million at July 31, 2007. The Company has thirty days from the closing date of the transaction to vacate the properties, all of which were operated as retail stores at July 31, 2007.

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 July 31, 2007 we operated 142 stores in 35 states, predominantly in small to medium-sized markets under the trade name "REX".

In fiscal year 2006, we entered the alternative energy industry by investing in several entities organized to construct and, subsequently operate, ethanol producing plants. As we continue to seek to diversify sources of revenue and earnings, we have invested in five entities as of July 31, 2007, utilizing both debt and equity investments.

Since fiscal year 1998, we invested in three entities which owned facilities producing synthetic fuel. These entities earn federal income tax credits under Section 29/45K of the Internal Revenue Code based on the tonnage and content of solid synthetic fuel produced and sold to related parties. We have sold our entire ownership interest in these entities in prior years, and as a result, receive payments in connection with current production of synthetic fuel.

Fiscal Year

All references in this report to a particular fiscal year are to REX's fiscal year ended January 31. For example, "fiscal year 2007" means the period February 1, 2007 to January 31, 2008.

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:

| | Three Months Ended July 31 | | Six Months Ended July 31 | |
|--|----------------------------------|--------|--------------------------------|--------|
| | 2007 | 2006 | 2007 | 2006 |
| Net sales and revenue | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of merchandise sold | 68.7 | 72.0 | 69.0 | 71.7 |
| Gross profit | 31.3 | 28.0 | 31.0 | 28.3 |
| Selling, general and administrative expenses | 30.1 | 27.8 | 29.7 | 27.7 |
| Interest income | 3.5 | 0.5 | 2.9 | 0.4 |
| Interest expense | (0.2) | (0.6) | (0.2) | (0.6) |
| Loss on early termination of debt | - | - | (0.6) | - |
| Gains on sale of real estate | 0.1 | 2.7 | 0.7 | 1.3 |
| Equity in income of unconsolidated ethanol affiliates | 0.7 | - | 1.3 | - |
| Income from synthetic fuel investments | 6.0 | 1.1 | 8.9 | 2.1 |
| Income from continuing operations before provision for income taxes, minority interest and discontinued operations | 11.3 | 3.9 | 14.3 | 3.8 |
| Provision for income taxes | 4.6 | 1.4 | 5.7 | 1.4 |
| Income from continuing operations | 6.7 | 2.5 | 8.6 | 2.4 |
| Minority interest | - | - | - | - |
| Loss from discontinued operations, net of tax | (1.0) | (0.1) | (1.3) | (0.1) |
| Gain on disposal of discontinued operations, net of tax | 4.6 | - | 4.4 | - |
| Net income | 10.3% | 2.4% | 11.7% | 2.3% |

Business Segment Results

As discussed in Note 17, our chief operating decision maker (as defined by SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information) evaluates the operating performance of our business segments using a measure we call segment profit. Segment profit excludes income taxes, interest expense, discontinued operations, indirect interest income and certain other items that are included in net income determined in accordance with accounting principles generally accepted in the United States of America. Management believes these are useful financial measures; however, they should not be construed as being more important than other comparable GAAP measures.

Items excluded from segment profit generally result from decisions made by corporate executives. Financing, divestiture and tax structure decisions are generally made by corporate executives. Excluding these items from our business segment performance measure enables us to evaluate business segment operating performance based upon current economic conditions.

The following table sets forth, for the periods indicated, sales and profits by segment (amounts in thousands):

| | Quarters Ended July | | Six Months Ended July | |
|---|---------------------|-----------|-----------------------|------------|
| | 2007 | 2006 | 2007 | 2006 |
| Net sales and revenue: | | | | |
| Retail | \$ 56,264 | \$ 63,583 | \$ 113,955 | \$ 129,572 |
| Alternative energy | - | - | - | - |
| Total net sales and revenues | \$ 56,264 | \$ 63,583 | \$ 113,955 | \$ 129,572 |
| Segment profit: | | | | |
| Retail segment profit | \$ 1,951 | \$ 2,584 | \$ 4,702 | \$ 3,700 |
| Alternative energy segment profit (loss) | 746 | (379) | 2,112 | (402) |
| Corporate expense | (865) | (354) | (1,476) | (889) |
| Interest expense | (121) | (398) | (937) | (799) |
| Interest income | 1,213 | 287 | 1,839 | 577 |
| Income from synthetic fuel investments | 3,406 | 723 | 10,139 | 2,785 |
| Income from continuing operations before income taxes | \$ 6,330 | \$ 2,463 | \$ 16,379 | \$ 4,972 |

Comparison of Three Months and Six Months Ended July 31, 2007 and 2006

All of our net sales and revenue was generated by our retail segment, as the only ethanol entity we consolidate did not have an operating plant in the first six months of fiscal year 2007 or 2006. Net sales and revenue in the quarter ended July 31, 2007 were \$56.3 million compared to \$63.6 million in the prior year's second quarter, representing a decrease of \$7.3 million or 11.5%. Net sales and revenue do not include merchandise sales from stores classified as discontinued operations.

This decrease was primarily caused by a decrease in comparable store sales of 12.0% for the second quarter of fiscal year 2007. 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.

The appliance category negatively impacted comparable store sales by 1.7%. The appliance category performance was primarily due to lower sales of air conditioners. The television category negatively impacted comparable store sales by 5.5%. This resulted from gains in LCD television sales being more than offset by declines in plasma, light engine and traditional tube televisions. The audio category negatively impacted comparable store sales by 2.9%. The video category negatively impacted comparable store sales by 1.6%. Both the audio and video categories have been impacted by lower price points of their respective products, as these products are continuing to become more of a commodity item with very high levels of competition.

Net sales and revenue for the first six months of fiscal year 2007 were \$114.0 million compared to \$129.6 million for the first six months of fiscal year 2006. This represents a decrease of \$15.6 million or 12.0% . This decrease was primarily caused by a decrease in comparable store sales of 11.0% for the first half of fiscal year 2007.

The appliance product category positively impacted comparable store sales for the first six months of fiscal 2007 by 1.3% . The appliance category increase is related to an increased promotional effort and an increase in the breadth of products offered. These positive trends were offset by a decline in air conditioner sales. The television, audio and video categories negatively impacted comparable store sales for the first six months of fiscal year 2007 by 7.4%, 3.1% and 1.4%, respectively. The television category decrease results from gains in LCD television sales being more than offset by declines in plasma, light engine and traditional tube televisions. The audio and video categories results 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 for each major product group for the following periods:

| <u>Product Category</u> | <u>Three Months</u> <u>Ended July 31,</u> | | <u>Six Months</u> <u>Ended July 31,</u> | |
|-------------------------|--|-------------|--|-------------|
| | <u>2007</u> | <u>2006</u> | <u>2007</u> | <u>2006</u> |
| Televisions | 48.5% | 47.5% | 50.6% | 52.1% |
| Appliances | 35.4 | 33.9 | 32.4 | 28.4 |
| Audio | 4.0 | 6.9 | 4.9 | 7.7 |
| Video | 2.5 | 3.8 | 2.6 | 3.7 |
| Extended warranties | 5.7 | 3.7 | 5.2 | 3.5 |
| Other | 3.9 | 4.2 | 4.3 | 4.6 |
| | 100.0% | 100.0% | 100.0% | 100.0% |

As of July 31, 2007, we operated 142 stores compared to 210 stores one year earlier. We did not open any stores and closed 51 stores during the first six months of fiscal year 2007. We are marketing five of the closed locations for lease or sale. We sold 39 of the closed stores and abandoned seven of the stores upon the expiration of our lease as tenant. We did not open any stores and closed eight stores during the first six months of fiscal year 2006.

At July 31, 2007, we had lease agreements, as landlord/sub landlord, for all or parts of 15 properties. We own 12 of these properties and are the tenant/sub landlord for three of the properties. In five of the owned locations, we operate a store and lease a portion of the property to another party. We do not operate a store in seven of the owned properties. We have seven owned properties that are vacant at July 31, 2007. The assets for one of these properties are classified as assets held for sale.

Gross profit in the second quarter of fiscal year 2007 was \$17.6 million (31.3% of net sales and revenue) compared to \$17.8 million (28.0% of net sales and revenue) recorded in the second quarter of fiscal year 2006. This represents a decrease of \$0.2 million or 1.1% . Gross profit for the

first six months of fiscal year 2007 was \$35.4 million (31.0 % of net sales and revenue) compared to \$36.6 million (28.3 % of net sales and revenue) for the first six months of fiscal year 2006. Gross profit margin for the second quarter and first half of fiscal year 2007 was negatively impacted by approximately \$0.6 million and \$1.5 million, respectively, as a result of having 68 net fewer stores compared to the prior year. Gross profit margin for the second quarter and first six months of fiscal year 2006 was positively impacted by a higher percentage of recognized extended warranty income, which has higher gross margins than other revenue categories.

Selling, general and administrative expenses for the second quarter of fiscal year 2007 were \$17.0 million (30.1% of net sales and revenue), a decrease of \$0.5 million or 2.9% from \$17.5 million (27.8% of net sales and revenue) for the second quarter of fiscal year 2006. Selling, general and administrative expenses were \$33.9 million (29.7% of net sales and revenue) for the first six months of fiscal year 2007 representing a decrease of \$2.0 million or 5.6% from \$35.9 million (27.7% of net sales and revenue) for the first six months of fiscal year 2006. The decrease in expenses was primarily a result of lower advertising expenses as we had fewer markets to serve after our store closings.

Interest income was \$1,976,000 and \$287,000 for the second quarter of fiscal years 2007 and 2006 respectively. Excess cash, primarily from the sale of real estate accounted for approximately \$1,015,000 of the increase while ethanol investments accounted for approximately \$711,000 of the increase.

Interest income was \$3,269,000 and \$579,000 for the first six months of fiscal years 2007 and 2006 respectively. Excess cash, primarily from the sale of real estate accounted for approximately \$1,268,000 of the increase while ethanol investments accounted for approximately \$1,408,000 of the increase.

Interest expense was \$121,000 for the second quarter of fiscal year 2007 compared to \$398,000 for the second quarter of fiscal year 2006. Interest expense was \$286,000 for the first six months of fiscal year 2007 compared to \$799,000 for the first six months of fiscal year 2006. Interest expense for the current year has been lowered due to capitalizing interest on certain of our ethanol investments.

We paid off approximately \$15.6 million of debt in connection with the real estate sale and leaseback transaction with Klac. As a result, we incurred prepayment penalties and the write off of prepaid loan fees totaling approximately \$651,000.

On April 30, 2007, we completed a transaction for the sale of 86 of our current and former store locations to Klac for \$74.5 million in cash, before selling expenses. We also entered into leases to leaseback 40 of the properties from Klac for initial lease terms expiring January 31, 2010, with renewal options for up to 15 additional years. Both parties may terminate a lease after the initial six months of the initial lease term on 28 of the leases. We also entered into license agreements with Klac for 15 of the properties that allowed us to occupy the properties for up to 90 days rent free. Upon the expiration of the license period, we vacated the 15 properties.

A pre-tax gain of \$3.2 million (net of expenses and losses) resulted from this sale in the first quarter of fiscal year 2007. Of this gain, \$2.2 million was classified as discontinued operations and the remaining \$1.0 million was classified as continuing operations. We also deferred \$11.6 million, which represented the present value of the minimum lease payments and a portion of the gain associated with stores that we had continuing involvement with, as defined in SFAS 98, "Accounting for Leases". We had a gain from the disposal of discontinued operations, net of tax expense, of approximately \$2.6 million for the second quarter of fiscal year 2007 and approximately \$5.0 million for the first six months of fiscal year 2007.

The following table summarizes the components of the sale and leaseback transaction (amounts in thousands):

| Property Category | Number of Properties | Deferred Gain | Recognized Gain (Loss) |
|--|----------------------|---------------|------------------------|
| Vacated | 47 | \$ - | \$ 5,833 |
| Leased until January 31, 2010 | 12 | 4,087 | (68) |
| Leased until January 31, 2010 (6 month kickout clause) | 27 | 3,590 | 1,363 |
| Total | 86 | \$ 7,677 | \$ 7,128 |

During the second quarter and six months ended July 31, 2006, we completed a sale and leaseback agreement for one owned property for a pre-tax gain of approximately \$1.7 million.

During the second quarter of fiscal year 2007, we recognized income of approximately \$309,000 and \$103,000 from our equity investments in Big River Resources, LLC and Patriot Renewable Fuels, LLC, respectively. During the first six months of fiscal year 2007, we recognized income of approximately \$1,379,000 and \$143,000 from our equity investments in Big River Resources, LLC and Patriot Renewable Fuels, LLC, respectively.

Results for the second quarter and first six months of fiscal years 2007 and 2006 reflect the impact of the sales of our investment in Colona SynFuel Limited Partnership, L.L.L.P. (Colona) and Somerset Synfuel, L.P. (Somerset), which produce synthetic fuel. We sold our ownership interest in the Colona limited partnership through a series of three sales. During the first quarter of fiscal year 2007, we recorded approximately \$909,000 of income which relates to a payment received for 2006 production. The 2006 production payments were based upon estimated income tax credits per ton of coal produced. The \$909,000 payment was made to us after the Internal Revenue Service published the 2006 income tax credit per ton amount in April of 2007. During the first quarter of fiscal year 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. Effective October 1, 2005, we sold our entire ownership interest in the Somerset limited partnership that owned two synthetic fuel facilities.

We also sold our entire membership interest in a limited liability company that owned a 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. The plant was subsequently sold and during the third quarter of fiscal year 2006, we modified our agreement with the owners and operators of the synthetic fuel facility. Based on the terms of the agreement, we are not currently able to determine the likelihood of collecting payments related to production occurring after September 30, 2006. Thus, we cannot currently determine the impact and timing of income recognition related to production occurring after September 30, 2006. At July 31, 2007, we estimate that there is approximately 4.0 million tons of production for which we did not recognize income. See Note 12 for further discussion of income from synthetic fuel sales.

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

| | Three Months Ended | | Six Months Ended | |
|-------------------------------|--------------------|-------------|------------------|-------------|
| | <u>July 31,</u> | | <u>July 31,</u> | |
| | <u>2007</u> | <u>2006</u> | <u>2007</u> | <u>2006</u> |
| February 1, 1999 Colona sale | \$ 949 | \$ 103 | \$ 2,894 | \$ 362 |
| July 31, 2000 Colona sale | 757 | 82 | 2,309 | 556 |
| May 31, 2001 Colona sale | 673 | 73 | 2,052 | 494 |
| October 1, 2005 Somerset sale | 1,027 | 465 | 2,884 | 950 |
| March 30, 2004 Gillette sale | - | - | - | 423 |
| | \$ 3,406 | \$ 723 | \$ 10,139 | \$ 2,785 |

Our effective tax rate was 40.7% and 36.3% for the second quarter of fiscal years 2007 and 2006, respectively. Our effective tax rate was 39.4% and 37.1% for the first six months of fiscal years 2007 and 2006, respectively.

Minority interest of \$54,000 for the quarter ended July 31, 2007 and (\$41,000) for the six months ended July 31, 2007, represents the owners' (other than us) share of the income of Levelland/Hockley County Ethanol, LLC.

During the quarter and six months ended July 31, 2007 we closed 21 and 46 stores, respectively, that were classified as discontinued operations. As a result of these closings and certain other store closings from prior periods, we had a loss from discontinued operations, net of tax benefit, of \$0.6 million for the second quarter of fiscal year 2007 compared to \$0.1 million for the second quarter of fiscal year 2006. We had a loss from discontinued operations, net of tax benefit, of \$1.5 million for the first six months of fiscal year 2007 compared to \$0.1 million for the first six months of fiscal year 2006.

As a result of the foregoing, net income for the second quarter of fiscal year 2007 was \$5.8 million, an increase of \$4.3 million from \$1.5 million for the second quarter of fiscal year 2006. Net

income for the first six months of fiscal year 2007 was \$13.3 million, an increase of \$10.3 million from \$3.0 million for the first six months of fiscal year 2006.

Liquidity and Capital Resources

Net cash used in operating activities was approximately \$17.8 million for the first six months of fiscal year 2007, compared to \$12.9 million for the first six months of fiscal year 2006. For the first six months of fiscal year 2007, cash was provided by net income of \$13.3 million, adjusted for the impact of \$10.1 million for gains on our installment sales of the limited partnership interests, the gain on the disposal of real estate and property and equipment of \$9.0 million and non-cash items of \$2.3 million, which consisted of depreciation and amortization, stock based compensation expense, impairment charges, income and dividends from equity method investments, deferred income and the deferred income tax provision. In addition, accounts payable provided cash of \$16.3 million, primarily a result of changes in inventory levels and extended terms from certain vendors. The primary use of cash was an increase in inventory of \$14.2 million primarily due to seasonal fluctuations. The inventory increase from January 31, 2007 primarily results from higher television and air conditioner levels. The other use of cash was an increase in other assets of \$9.6 million.

For the first six months of fiscal year 2006, cash was provided by net income of \$3.0 million, adjusted for the impact of \$2.8 million for gains on our installment sales of the limited partnership interests, non-cash items of \$2.5 million, which consisted of depreciation and amortization, stock based compensation expense, impairment charges, deferred income and gain on disposal of fixed assets. In addition, accounts payable provided cash of \$12.4 million, primarily a result of changes in inventory levels. The primary use of cash was an increase in inventory of \$26.0 million primarily due to seasonal fluctuations. The other use of cash was a decrease in other current liabilities of \$2.3 million.

At July 31, 2007, working capital was \$119.4 million compared to \$83.8 million at January 31, 2007. This increase is primarily a result of the real estate sale and leaseback transaction and greater cash proceeds from our synthetic fuel investments. The ratio of current assets to current liabilities was 2.7 to 1 and 2.6 to 1 at July 31, 2007 and January 31, 2007, respectively.

Cash of \$76.6 million was provided by investing activities for the first six months of fiscal year 2007, compared to cash used of \$2.1 million for the first six months of fiscal year 2006. During the first six months of fiscal year 2007, we received proceeds of \$79.7 million from the sale and leaseback transaction with Klac and other real estate sales and \$15.1 million from the installment sales of our ownership interests in synthetic fuel entities. We purchased an ethanol related note of \$3.0 million during the first six months of fiscal year 2007. We had capital expenditures of approximately \$15.2 million during the first six months of fiscal year 2007, primarily related to the Levelland/Hockley County Ethanol, LLC ethanol plant construction.

Cash of \$2.1 million was used in investing activities for the first six months of fiscal year 2006. We paid \$5.6 million for a note investment in Levelland/Hockley and received proceeds of \$2.6 million from the sale of real estate and fixed assets during the first half of fiscal year 2006. Additionally, during the first half of fiscal year 2006, we received proceeds of \$1.3 million from installment sales of our ownership interests in synthetic fuel entities. We had capital expenditures of

approximately \$0.3 million during the first half of fiscal 2006, primarily related to improvements at selected stores.

Cash used in financing activities totaled approximately \$11.5 million for the first six months of fiscal year 2007 compared to cash provided by financing activities of \$0.4 million for the first six months of fiscal year 2006. Cash of approximately \$17.6 million was used to repay mortgage debt. Cash was provided by new debt borrowings of \$5.0 million and stock option activity of \$4.9 million. Cash of approximately \$3.8 million was also used to acquire 195,000 shares of our common stock. As of July 31, 2007, we had approximately 805,000 authorized shares remaining available for purchase under the stock buy-back program.

Cash provided by financing activities totaled approximately \$0.4 million for the first six months of fiscal year 2006. Cash was provided by stock option activity of \$1.6 million. Cash of \$1.2 million was used for scheduled payments of mortgage debt.

On June 15, 2007, we entered into a contingent agreement to subscribe for a minimum of \$35.1 million and a maximum of \$62.4 million of membership units of One Earth in a registered offering. This replaced our prior commitment to fund \$24.9 million in One Earth. One Earth intends to commence construction, beginning in 2007, of an ethanol manufacturing facility in Gibson City, Illinois, with an annual production capacity of 100 million gallons. Our commitment will enable us to secure a majority ownership interest in One Earth.

In addition, we have entered into a conditional agreement with One Earth to fund up to an additional \$6.0 million in interim financing in the form of secured debt, bearing an interest rate of 9% per annum. As of July 31, 2007, we have funded \$3.0 million of the interim financing.

We believe we have sufficient resources to fund these and other potential ethanol investments.

In June 2006, Levelland/Hockley entered into an agreement with a designer/builder for the construction of Levelland's ethanol plant. The designer/builder is responsible for all engineering, labor, materials and equipment to design, construct, startup and achieve guaranteed performance criteria of the plant. The contract price is approximately \$58.4 million, of which \$17.4 million has been spent through July 31, 2007.

On July 25, 2002, Levelland/Hockley entered into an agreement with RIO Technical Services, Inc., (RIO) regarding the planning, financing, design and construction of Levelland's ethanol plant. RIO is a related party, as certain officers of RIO own equity interests in Levelland/Hockley. The Company estimates that fees for these services will be approximately \$3.0 million, of which approximately \$1.0 million has been spent through July 31, 2007.

We believe that Levelland/Hockley will begin borrowing on its construction loan during the third quarter of fiscal 2007; thus, we anticipate incurring additional interest expense subsequent to July 31, 2007.

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. Such statements can be identified by use of forward-looking terminology such as "may," "expect," "believe," "estimate," "anticipate" or "contingent" and the negative thereof or other variations thereon or comparable terminology. Readers are cautioned that there are risks and uncertainties that could cause actual events or results to differ materially from those referred to in such forward-looking statements. These risks and uncertainties include the risk factors set forth from time to time in the Company's filings with the Securities and Exchange Commission and among other things: risks and uncertainties relating to the acquisition of REX Stores' interest in Millennium Ethanol, LLC by U.S. BioEnergy Corporation including, but not limited to the uncertainty of the financial performance of U.S. BioEnergy Corporation following completion of the transaction; fluctuations in the market prices and trading volumes of U.S. BioEnergy Corporation common stock; 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, changes in real estate market conditions, 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 interest in a synthetic fuel investment, the potential for Section 29/45K tax credits to phase out based on the price of crude oil adjusted for inflation, and the uncertain amount of synthetic fuel production and resulting income received from time to time from the Company's synthetic fuel investments. As it relates to ethanol investments, risks and uncertainties include among other things: the uncertainty of constructing plants on time and on budget, the price volatility of corn, dried distiller grains, ethanol, gasoline and natural gas, and the ability to remain in compliance with related debt covenants. 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, 2007 (File No. 001-09097).

Item 3. Quantitative and Qualitative Disclosures About Market Risk

No material changes since January 31, 2007.

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 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.

PART II. OTHER INFORMATION

Item 1A. Risk Factors

During the quarter ended July 31, 2007, 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, 2007.

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

Issuer Purchases of Equity Securities

| <u>Period</u> | <u>Total Number of Shares Purchased</u> | <u>Average Price Paid per Share</u> | <u>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)</u> | <u>Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (1)</u> |
|-----------------|---|-------------------------------------|---|---|
| May 1-31, 2007 | - | \$ - | - | 496,645 |
| June 1-30, 2007 | 126,600 | \$ 18.70 | 126,600 | 873,400 |
| July 1-31, 2007 | 68,800 | \$ 20.53 | 68,800 | 804,600 |
| Total | 195,400 | \$ 19.34 | 195,400 | 804,600 |

(1) On June 1, 2007, the Company announced it had increased the authorization to purchase shares of its common stock from 496,645 to 1,000,000 shares from time to time in private or market transactions at prevailing market prices. At July 31, 2007, a total of 804,600 shares remained available to purchase under this authorization.

Item 6. Exhibits.

The following exhibits are filed with this report:

- 31 Rule 13a-14(a)/15d-14(a) Certifications
- 32 Section 1350 Certifications

SIGNATURES

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) | September 6, 2007 |
| /s/ Douglas L. Bruggeman (Douglas L. Bruggeman) | Vice President, Finance and Treasurer (Chief Financial Officer) | September 6, 2007 |