

AMERICAS CARMART INC  
Form 10-Q  
December 11, 2006

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

**FORM 10-Q**

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

For the fiscal quarter ended:  
**October 31, 2006**

Commission file number:  
**0-14939**

**AMERICA'S CAR-MART, INC.**

(Exact name of registrant as specified in its charter)

**Texas**

(State or other jurisdiction of incorporation or organization)

**63-0851141**

(I.R.S. Employer Identification No.)

**802 Southeast Plaza Ave., Suite 200, Bentonville, Arkansas 72712**

(Address of principal executive offices, including zip code)

**(479) 464-9944**

(Registrant's telephone number, including area code)

**Not Applicable**

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

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| <u>Title of Each Class</u>              | <u>Outstanding at<br/>December 11, 2006</u> |
|---|---|
| Common stock, par value \$.01 per share | 11,852,875                                  |

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**Part I. FINANCIAL INFORMATION****Item 1. Financial Statements**

America's Car-Mart, Inc.

**Condensed Consolidated Balance Sheets**

(Dollars in thousands)

|   | October 31, 2006<br>(unaudited) | April 30, 2006 |
|---|---------------------------------|----------------|
| Assets:   |                                 |                |
| Cash and cash equivalents   | \$ 38                           | \$ 255         |
| Accrued interest on finance receivables   | 880                             | 818            |
| Finance receivables, net  | 147,512                         | 149,379        |
| Inventory   | 14,713                          | 10,923         |
| Prepaid expenses and other assets   | 1,061                           | 802            |
| Income taxes receivable   | 29                              | -              |
| Deferred tax asset  | 270                             | -              |
| Property and equipment, net   | 16,233                          | 15,436         |
|   | \$ 180,736                      | \$ 177,613     |
| Liabilities and stockholders' equity:   |                                 |                |
| Accounts payable  | \$ 2,192                        | \$ 3,095       |
| Accrued liabilities   | 8,079                           | 8,743          |
| Income taxes payable  | -                               | 1,847          |
| Deferred tax liabilities  | -                               | 1,089          |
| Revolving Credit Facilities and notes payable   | 48,934                          | 43,588         |
|   | 59,205                          | 58,362         |
| Commitments and contingencies – See Note  |                                 |                |
| Stockholders' equity:   |                                 |                |
| Preferred stock, par value \$.01 per share, 1,000,000 shares authorized;<br>none issued or outstanding                        | -                               | -              |
| Common stock, par value \$.01 per share, 50,000,000 shares<br>authorized;<br>11,964,125 issued (11,929,274 at April 30, 2006) | 119                             | 119            |
| Additional paid-in capital  | 35,095                          | 34,588         |
| Retained earnings   | 88,269                          | 86,042         |
| Less: Treasury stock, at cost, 111,250 shares (81,250 at April 30,<br>2006)   | (1,952)                         | (1,498)        |
| Total stockholders' equity  | 121,531                         | 119,251        |
|   | \$ 180,736                      | \$ 177,613     |

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

**Consolidated Statements of Operations**  
**(Unaudited)**
**America's Car-Mart, Inc.**

(Dollars in thousands)

|   | Three Months Ended<br>October 31, |            | Six Months Ended<br>October 31, |            |
|---|-----------------------------------|------------|---------------------------------|------------|
|   | 2006                              | 2005       | 2006                            | 2005       |
| <b>Revenues:</b>  |                                   |            |                                 |            |
| Sales   | \$ 53,669                         | \$ 50,581  | \$ 110,007                      | \$ 104,177 |
| Interest income   | 5,870                             | 4,748      | 11,723                          | 9,331      |
|   | 59,539                            | 55,329     | 121,730                         | 113,508    |
| <b>Costs and expenses:</b>                                |                                   |            |                                 |            |
| Cost of sales   | 31,140                            | 28,114     | 62,476                          | 57,375     |
| Selling, general and administrative                       | 10,446                            | 9,610      | 20,916                          | 18,941     |
| Provision for credit losses                               | 19,848                            | 12,459     | 32,504                          | 23,660     |
| Interest expense  | 927                               | 567        | 1,829                           | 1,045      |
| Depreciation and amortization                             | 239                               | 130        | 470                             | 278        |
|   | 62,600                            | 50,880     | 118,195                         | 101,299    |
| Income (loss) before taxes                                | (3,061)                           | 4,449      | 3,535                           | 12,209     |
| Provision for income taxes                                | (1,133)                           | 1,650      | 1,308                           | 4,522      |
| Net Income (Loss)   | \$ (1,928)                        | \$ 2,799   | \$ 2,227                        | \$ 7,687   |
| <b>Earnings (loss) per share:</b>                         |                                   |            |                                 |            |
| Basic   | \$ (.16)                          | \$ .24     | \$ .19                          | \$ .65     |
| Diluted   | \$ (.16)                          | \$ .23     | \$ .19                          | \$ .64     |
| <b>Weighted average number of shares<br/>outstanding:</b> |                                   |            |                                 |            |
| Basic   | 11,844,101                        | 11,855,982 | 11,847,449                      | 11,850,609 |
| Diluted   | 11,844,101                        | 12,030,908 | 11,969,592                      | 12,035,926 |

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

**Consolidated Statements of Cash Flows**  
**(Unaudited)**  
**(In thousands)**

**America's Car-Mart, Inc.**

|   | Six Months Ended<br>October 31, |          |
|---|---------------------------------|----------|
|   | 2006                            | 2005     |
| Operating activities:   |                                 |          |
| Net income  | \$ 2,227                        | \$ 7,687 |
| Adjustments to reconcile net income to net cash used in operating activities: |                                 |          |
| Provision for credit losses   | 32,504                          | 23,660   |
| Depreciation and amortization   | 470                             | 278      |
| Loss on sale of property and equipment  | -                               | 15       |
| Stock based compensation expense  | 308                             | -        |
| Deferred income taxes   | (1,358)                         | 433      |
| Changes in operating assets and liabilities:                                  |                                 |          |
| Finance receivable originations   | (100,846)                       | (95,695) |
| Finance receivable collections  | 60,735                          | 53,057   |
| Accrued interest on finance receivables                                       | (62)                            | (185)    |
| Inventory   | 6,038                           | 5,370    |
| Prepaid expenses and other assets   | (152)                           | (238)    |
| Accounts payable and accrued liabilities                                      | (1,567)                         | 1,781    |
| Income taxes payable  | (1,876)                         | (209)    |
| Net cash used in operating activities   | (3,579)                         | (4,046)  |
| Investing activities:   |                                 |          |
| Purchase of property and equipment  | (1,299)                         | (2,485)  |
| Proceeds from sale of property and equipment                                  | 31                              | 157      |
| Payment for businesses acquired   | (460)                           | -        |
| Net cash used in investing activities   | (1,728)                         | (2,328)  |
| Financing activities:   |                                 |          |
| Exercise of stock options and related tax benefit                             | 164                             | 218      |
| Purchase of common stock  | (454)                           | (391)    |
| Issuance of common stock  | 35                              | -        |
| Proceeds from notes payable   | 11,200                          | -        |
| Principal payments on notes payable   | (308)                           | -        |
| Proceeds from (repayments of) revolving credit facilities, net                | (5,547)                         | 6,408    |
| Net cash provided by financing activities                                     | 5,090                           | 6,235    |
| Decrease in cash and cash equivalents   | (217)                           | (139)    |
| Cash and cash equivalents at:      Beginning of period                        | 255                             | 459      |
| End of period   | \$ 38                           | \$ 320   |

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



**Notes to Consolidated Financial Statements (Unaudited)****America's Car-Mart, Inc.****A – Organization and Business**

America's Car-Mart, Inc., a Texas corporation (the "Company"), is the largest publicly held automotive retailer in the United States focused exclusively on the "Buy Here/Pay Here" segment of the used car market. References to the Company typically include the Company's consolidated subsidiaries. The Company's operations are principally conducted through its two operating subsidiaries, America's Car-Mart, Inc., an Arkansas corporation, ("Car-Mart of Arkansas") and Colonial Auto Finance, Inc. ("Colonial"). Collectively, Car-Mart of Arkansas and Colonial are referred to herein as "Car-Mart". The Company primarily sells older model used vehicles and provides financing for substantially all of its customers. Many of the Company's customers have limited financial resources and would not qualify for conventional financing as a result of limited credit histories or past credit problems. As of October 31, 2006, the Company operated 90 stores located primarily in small cities throughout the South-Central United States.

**B – Summary of Significant Accounting Policies***General*

The accompanying unaudited financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and six month periods ended October 31, 2006 are not necessarily indicative of the results that may be expected for the year ending April 30, 2007. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-K for the year ended April 30, 2006.

*Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

*Concentration of Risk*

The Company provides financing in connection with the sale of substantially all of its vehicles. These sales are made primarily to customers residing in Arkansas, Oklahoma, Texas, Kentucky and Missouri, with approximately 55% of revenues from customers residing in Arkansas. The Company maintains a security interest in the vehicles sold. Periodically, the Company maintains cash in financial institutions in excess of the amounts insured by the federal government. Car-Mart's revolving credit facilities mature in April 2009. The Company expects that these credit facilities will be renewed or refinanced on or before the scheduled maturity dates.

*Restrictions on Subsidiary Distributions/Dividends*

Car-Mart's revolving credit facilities limit distributions from Car-Mart to the Company beyond (i) the repayment of an intercompany loan (\$10.0 million at October 31, 2006), and (ii) dividends equal to 75% of Car-Mart of Arkansas' net income. At October 31, 2006, the Company's assets (excluding its \$109 million equity investment in Car-Mart) consisted of \$25,000 in cash, \$3.1 million in other assets and a \$10.0 million receivable from Car-Mart. Thus, the

Company is limited in the amount of dividends or other distributions it can make to its shareholders without the consent of Car-Mart's lender. Beginning in February 2003, Car-Mart assumed substantially all of the operating costs of the Company.



*Finance Receivables, Repossessions and Charge-offs and Allowance for Credit Losses*

The Company originates installment sale contracts from the sale of used vehicles at its dealerships. Finance receivables are collateralized by vehicles sold and consist of contractually scheduled payments from installment contracts net of unearned finance charges and an allowance for credit losses. Unearned finance charges represent the balance of interest income remaining from the total interest to be earned over the term of the related installment contract. An account is considered delinquent when a contractually scheduled payment has not been received by the scheduled payment date. At October 31, 2006 and 2005, 5.4% and 4.1%, respectively, of the Company's finance receivable balance were 30 days or more past due.

The Company takes steps to repossess a vehicle when the customer becomes delinquent in his or her payments, and management determines that timely collection of future payments is not probable. Accounts are charged-off after the expiration of a statutory notice period for repossessed accounts, or when management determines that timely collection of future payments is not probable for accounts where the Company has been unable to repossess the vehicle. For accounts where the vehicle has been repossessed, the fair value of the repossessed vehicle is a reduction of the gross finance receivable balance charged-off. On average, accounts are approximately 60 days past due at the time of charge-off. For previously charged-off accounts that are subsequently recovered, the amount of such recovery is credited to the allowance for credit losses.

The Company maintains an allowance for credit losses on an aggregate basis at a level it considers sufficient to cover estimated losses in the collection of its finance receivables. The allowance for credit losses is based primarily upon historical and recent credit loss experience, with consideration given to recent credit loss trends and changes in loan characteristics (i.e., average amount financed and term), delinquency levels, collateral values, economic conditions and underwriting and collection practices. The allowance for credit losses is periodically reviewed by management with any changes reflected in current operations. Although it is at least reasonably possible that events or circumstances could occur in the future that are not presently foreseen which could cause actual credit losses to be materially different from the recorded allowance for credit losses, the Company believes that it has given appropriate consideration to all relevant factors and has made reasonable assumptions in determining the allowance for credit losses.

During the three month period ended October 31, 2006, management increased the allowance for credit loss percentage from 19.2% to 22% due to recent higher credit loss experience and trends. A change in accounting estimate was recognized to reflect the decision to increase the allowance for credit losses, resulting in a pretax, non-cash charge of \$5,271,000.

*Inventory*

Inventory consists of used vehicles and is valued at the lower of cost or market on a specific identification basis. Vehicle reconditioning costs are capitalized as a component of inventory. Repossessed vehicles are recorded at fair value, which approximates wholesale value. The cost of used vehicles sold is determined using the specific identification method.

*Goodwill*

Goodwill reflects the excess of purchase price over the fair value of specifically identified net assets purchased. In accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangibles" ("SFAS 142"), goodwill and intangible assets deemed to have indefinite lives are not amortized but are subject to annual impairment tests. The impairment tests are based on the comparison of the fair value of the reporting unit to the carrying value of such unit. If the fair value of the reporting unit falls below its carrying value, goodwill is deemed to be impaired and a write-down of goodwill would be recognized. The Company's goodwill is included in Prepaid Expenses and Other at

October 31, 2006, at approximately \$460,000.

*Cash Overdraft*

The Company's primary disbursement bank account is set up to operate with a fixed \$100,000 cash balance. As checks are presented for payment, monies are automatically drawn against cash collections for the day and, if necessary, are drawn against one of its revolving credit facilities. The cash overdraft balance principally represents outstanding checks, net of any deposits in transit that as of the balance sheet date had not yet been presented for payment.

*Deferred Sales Tax*

Deferred sales tax represents a sales tax liability of the Company for vehicles sold on an installment basis in the State of Texas. Under Texas law, for vehicles sold on an installment basis, the related sales tax is due as the payments are collected from the customer, rather than at the time of sale.

*Income Taxes*

Income taxes are accounted for under the liability method. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities, and are measured using the enacted tax rates expected to apply in the years in which these temporary differences are expected to be recovered or settled.

From time to time, the Company is audited by taxing authorities. These audits could result in proposed assessments of additional taxes. The Company believes that its tax positions comply in all material respects with applicable tax law. However, tax law is subject to interpretation, and interpretations by taxing authorities could be different from those of the Company, which could result in the imposition of additional taxes. See footnote H for a discussion of the status of the current Internal Revenue Service examination.

*Stock-based compensation*

On May 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards 123R, “*Share Based Payment*” (“SFAS 123R”), which revises Statement 123, “*Accounting for Stock-Based Compensation*,” and supersedes APB Opinion 25, “*Accounting for Stock Issued to Employees*.” SFAS 123R requires the Company to recognize expense related to the fair value of stock-based compensation awards, including employee stock options.

Prior to the adoption of SFAS 123R, the Company accounted for stock-based compensation awards using the intrinsic value method of Opinion 25. Accordingly, the Company did not recognize compensation expense in the statement of operations for options granted that had an exercise price equal to the market value of the underlying common stock on the date of grant. As required by Statement 123, the Company also provided certain pro forma disclosures for stock-based awards as if the fair-value-based approach of Statement 123 had been applied.

The Company has elected to use the modified prospective transition method as permitted by SFAS 123R and therefore has not restated financial results for prior periods. Under this transition method, the Company will apply the provisions of SFAS 123R to new awards and to awards modified, repurchased, or cancelled after May 1, 2006. All stock options and warrants outstanding at May 1, 2006 were fully vested.

The Company recorded compensation cost for stock-based employee awards of \$308,000 (\$194,000 after tax effects) during the six months ended October 31, 2006. The pretax amount includes \$178,000 for restricted shares issued on May 1, 2006. The Company had not previously issued restricted shares. Tax benefits were recognized for these costs at the Company’s overall effective tax rate.

As a result of the adoption of SFAS 123R, earnings were lower than under the previous accounting method for share-based compensation by the following amounts:

| <i>(Dollars in thousands)</i>                           | Six Months<br>Ended<br>October 31, 2006 |     |
|---|---|-----|
| Earnings from continuing operations before income taxes | \$                                      | 130 |
| Net earnings  | \$                                      | 82  |
| Basic and diluted net earnings per common share         | \$                                      | .01 |

Prior to the adoption of SFAS 123R, the Company presented all tax benefits resulting from the exercise of non-qualified stock options and any disqualifying disposition of vested stock options as operating cash flows in the

Consolidated Statement of Cash Flows. During the six months ended October 31, 2005 approximately \$77,000 in tax benefits relating to stock options exercised were included in operating cash flows. SFAS 123R requires that cash flows from the exercise of stock options resulting from tax benefits in excess of recognized cumulative compensation cost (excess tax benefits) be classified as financing cash flows. For the six months ended October 31, 2006, excess tax benefits relating to warrant exercises in the amount of \$127,000 were included in financing cash flows.

The following table illustrates the effect on net income after tax and net income per common share as if the Company had applied the fair value recognition provisions of SFAS 123 to stock-based compensation for the six months ended October 31, 2005:

| <i>(Dollars in thousands)</i>   | Six Months Ended<br>October 31, 2005 |       |
|---|--------------------------------------|-------|
| Net income, as reported   | \$                                   | 7,687 |
| Deduct: Stock-based employee compensation expense determined under fair value-based method for all awards, net of related tax effects |                                      | (100) |
| Pro forma net income  | \$                                   | 7,587 |
| Basic earnings per common share:  |                                      |       |
| As reported   | \$                                   | .65   |
| Pro forma   | \$                                   | .64   |
| Diluted earnings per common share:  |                                      |       |
| As reported   | \$                                   | .64   |
| Pro forma   | \$                                   | .63   |

The fair value of options granted is estimated on the date of grant using the Black-Scholes option pricing model based on the assumptions in the table below.

|                         | October 31,<br>2006 | October 31,<br>2005 |
|-------------------------|---------------------|---------------------|
| Expected term (years)   | 5.0                 | 5.0                 |
| Risk-free interest rate | 5.11%               | 4.5%                |
| Volatility              | 60%                 | 45%                 |
| Dividend yield          | -                   | -                   |

The expected term of the options is based on evaluations of historical and expected future employee exercise behavior. The risk-free interest rate is based on the U.S. Treasury rates at the date of grant with maturity dates approximately equal to the expected life at the grant date. Volatility is based on historical volatility of the Company's stock. The Company has not historically issued any dividends and does not expect to do so in the foreseeable future.

#### *Stock Options*

The shareholders of the Company have approved three stock option plans, including the 1986 Incentive Stock Option Plan ("1986 Plan"), the 1991 Non-Qualified Stock Option Plan ("1991 Plan") and the 1997 Stock Option Plan ("1997 Plan"). No additional option grants may be made under the 1986 and 1991 Plans. The 1997 Plan set aside 1,500,000 shares of the Company's common stock for grants to employees, directors and certain advisors of the Company at a price not less than the fair market value of the stock on the date of grant and for periods not to exceed ten years. The options vest upon issuance. At April 30, 2006, there were 40,808, shares of common stock available for grant under the 1997 Plan. Options granted under the Company's stock option plans expire in the calendar years 2008 through 2015.

Plan

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|  | 1986 | 1991 | 1997           |
|--|------|------|----------------|
| Minimum exercise price as a percentage of fair market value at date of grant | 100% | 100% | 100%           |
| Plan termination date  | N/A  | N/A  | April 30, 2015 |
| Shares available for grant at October 31, 2006                               | 0    | 0    | 29,558         |

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The following is a summary of the changes in outstanding options for the six months ended October 31, 2006:

|                                    | Shares   | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Life |
|------------------------------------|----------|--|---|
| Outstanding at beginning of period | 287,295  | \$ 10.38                                 | 61.2 Months   |
| Granted                            | 11,250   | \$ 20.47                                 | 116.1<br>Months   |
| Exercised                          | (10,000) | \$ 3.67                                  | -   |
| Outstanding at end of period       | 288,545  | \$ 11.00                                 | 58.5 Months   |

The grant-date fair value of options granted during the first six months of fiscal 2006 and 2005 was \$130,000 and \$99,891, respectively. The total intrinsic value of options exercised during the first six months of fiscal 2007 was \$150,970. The aggregate intrinsic value of outstanding options at October 31, 2006 is \$1,898,305.

The Company received cash from options exercised during the first six months of fiscal 2007 of \$36,667. The impact of these cash receipts is included in financing activities in the accompanying Consolidated Statement of Cash Flows.

#### *Warrants*

As of October 31, 2006, the Company had outstanding stock purchase warrants issued in 2004 to purchase 18,750 shares at prices ranging from \$11.83 to \$18.23 per share (weighted average exercise price of \$13.11). All of the warrants are presently exercisable and expire between 2008 and 2009. The warrants have a weighted average remaining contractual life of 21.8 months at October 31, 2006. There were 22,329 shares of stock purchased as the result of warrants exercised during the six months ended October 31, 2006. There were no warrants exercised during the six months ended 2005. The aggregate intrinsic value of all outstanding warrants at October 31, 2006 is \$46,600.

#### *Restricted Stock Plan*

The Company has a Restricted Stock Plan wherein a total of 39,978 shares were available for award at October 31, 2006. The associated compensation expense is spread equally over the service periods established at award date and is subject to the employee's continued employment by the Company. During the first quarter, 57,500 restricted shares were granted with a fair value of \$20.07 per share, the market price of the Company's stock on grant date. These restricted shares had a weighted average vesting period of 3.35 years and begin vesting on April 30, 2007.

The Company recorded a pre-tax expense of \$178,000 related to the restricted stock plan during the six months ended October 31, 2006.

There have been no modifications to any of the Company's outstanding share-based payment awards during the first six months of fiscal 2007.

As of October 31, 2006, the Company has \$1 million of total unrecognized compensation cost related to unvested awards granted under the Company's restricted stock plan, which the Company expects to recognize over a weighted-average remaining period of 3.1 years.

*Treasury Stock*

For the six month period ended October 31, 2006, the Company purchased 30,000 shares of its common stock to be held as treasury stock for a total cost of \$454,029. Treasury stock may be used for issuances under the Company's stock-based compensation plans or for other general corporate purposes.

*Recent Accounting Pronouncement*

From time to time, new accounting pronouncements are issued by the Financial Accounting Standards Board or other standard setting bodies which the Company adopts as of the specified effective date. Unless otherwise discussed, the Company believes the impact of recently issued standards which are not yet effective will not have a material impact on our consolidated financial statements upon adoption.

In June 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"), which will require companies to assess each income tax position taken using a two-step process. A determination is first made as to whether it is more likely than not that the position will be sustained, based upon the technical merits, upon examination by the taxing authorities. If the tax position is expected to meet the more likely than not criteria, the benefit recorded for the tax position equals the largest amount that is greater than 50% likely to be realized upon ultimate settlement of the respective tax position. The interpretation applies to income tax expense as well as any related interest and penalty expense.



FIN 48 requires that changes in tax positions recorded in a company's financial statements prior to the adoption of this interpretation be recorded as an adjustment to the opening balance of retained earnings for the period of adoption. FIN 48 will generally be effective for public companies for the first fiscal year beginning after December 15, 2006. The Company anticipates adopting the provisions of this interpretation during the first quarter of fiscal 2008. No determination has yet been made regarding the materiality of the potential impact of this interpretation on the Company's financial statements.

FASB Statement No. 154, Accounting Changes and Error Corrections - a replacement of APB Opinion No. 20 and FASB Statement No. 3 (SFAS No. 154) was issued in May 2005. SFAS No. 154 changes the requirements for the accounting for and reporting of a change in accounting principle. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of this new pronouncement in fiscal 2007 did not impact the Company's financial condition, results of operations or cash flows.

In September 2006, the FASB issued Statement of Financial Accounting Standard No. 157, "Fair Value Measurements" ("SFAS 157"), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. The Company will be required to adopt this standard in the first quarter of the fiscal year ending April 30, 2009. The Company is in the process of evaluating the expected effect of SFAS 157 on its consolidated financial statements and is not currently in a position to determine such effects.

### C – Finance Receivables

The Company originates installment sale contracts from the sale of used vehicles at its dealerships. These installment sale contracts typically include interest rates ranging from 6% to 19% per annum, are collateralized by the vehicle sold and provide for payments over periods generally ranging from 12 to 36 months. The components of finance receivables are as follows:

| <i>(In thousands)</i>            | October 31,<br>2006 | April 30,<br>2006 |
|----------------------------------|---------------------|-------------------|
| Gross contract amount            | \$ 213,093          | \$ 207,378        |
| Unearned finance charges         | (23,473)            | (22,135)          |
| Principal balance                | 189,620             | 185,243           |
| Less allowance for credit losses | (42,108)            | (35,864)          |
|                                  | \$ 147,512          | \$ 149,379        |

Changes in the finance receivables, net balance for the six months ended October 31, 2006 and 2005 are as follows:

| <i>(In thousands)</i>                            | Six Months Ended October 31, |            |
|--|------------------------------|------------|
|  | 2006                         | 2005       |
| Balance at beginning of period                   | \$ 149,379                   | \$ 123,099 |
| Finance receivable originations                  | 100,846                      | 95,695     |
| Finance receivables from acquisition of business | 353                          | -          |
| Finance receivable collections                   | (60,735)                     | (53,057)   |
| Provision for credit losses                      | (32,504)                     | (23,660)   |
| Inventory acquired in repossession               | (9,827)                      | (6,772)    |

|                          |    |         |    |         |
|--------------------------|----|---------|----|---------|
| Balance at end of period | \$ | 147,512 | \$ | 135,305 |
|--------------------------|----|---------|----|---------|

Changes in the finance receivables allowance for credit losses for the three months ended October 31, 2006 and 2005 are as follows:

| <i>(In thousands)</i>                   | Six Months Ended |           |
|---|------------------|-----------|
|   | October 31,      |           |
|   | 2006             | 2005      |
| Balance at beginning of period          | \$ 35,864        | \$ 29,251 |
| Provision for credit losses             | 32,504           | 23,660    |
| Net charge-offs                         | (26,403)         | (20,761)  |
| Allowance related to purchased accounts | 143              | -         |
| Balance at end of period                | \$ 42,108        | \$ 32,150 |

**D – Property and Equipment**

A summary of property and equipment is as follows:

| <i>(In thousands)</i>                          | October 31,<br>2006 | April 30,<br>2006 |
|--|---------------------|-------------------|
| Land   | \$ 5,219            | \$ 5,234          |
| Buildings and improvements                     | 5,932               | 5,093             |
| Furniture, fixtures and equipment              | 3,849               | 3,673             |
| Leasehold improvements                         | 3,539               | 3,292             |
| Less accumulated depreciation and amortization | (2,306)             | (1,856)           |
|  | \$ 16,233           | \$ 15,436         |

**E – Accrued Liabilities**

A summary of accrued liabilities is as follows:

| <i>(In thousands)</i>                 | October 31,<br>2006 | April 30,<br>2006 |
|---------------------------------------|---------------------|-------------------|
| Compensation                          | \$ 1,951            | \$ 2,594          |
| Cash overdraft                        | 2,361               | 2,441             |
| Deferred service contract revenue     | 1,524               | 1,627             |
| Deferred sales tax                    | 1,028               | 1,012             |
| Subsidiary redeemable preferred stock | 500                 | 500               |
| Interest                              | 256                 | 257               |
| Other                                 | 459                 | 312               |
|                                       | \$ 8,079            | \$ 8,743          |

**F – Debt Facilities**

The Company's debt consists of two revolving credit facilities totaling \$50 million and two term loans as follows:

| Lender              | Revolving Credit Facilities |                  |            |  | Balance at<br>October 31, 2006 | Balance at<br>April 30,<br>2006 |
|---------------------|-----------------------------|------------------|------------|--|--------------------------------|---------------------------------|
|                     | Total<br>Facility<br>Amount | Interest<br>Rate | Maturity   |  |                                |                                 |
| Bank of<br>Oklahoma | \$50.0<br>million           | Prime +/-        | April 2009 |  | \$38,041,539                   | \$43,588,443                    |

On April 28, 2006, Car-Mart and its lenders amended the credit facilities. The amended facilities set total borrowings allowed on the revolving credit facilities at \$50 million and established a new \$10 million term loan. The term loan was funded in May 2006 and calls for 120 consecutive and substantially equal installments beginning June 1, 2006. The interest rate on the term loan is fixed at 7.33%. The principal balance on the term loan was \$9,718,943 at October 31, 2006. The combined total for the Company's credit facilities and its term loan with its primary lender is \$60 million.

The facilities are collateralized by substantially all the assets of Car-Mart, including finance receivables, inventory and real property. Interest is payable monthly under the revolving credit facilities at the bank's prime lending rate or prime plus or minus quarter point increments depending upon the Company's ratio of funded debt to earnings before interest, taxes, depreciation and amortization (8.25% and 7.50% at October 31, 2006 and April 30, 2006, respectively). The facilities contain various reporting and performance covenants including (i) maintenance of certain financial ratios and tests, (ii) limitations on borrowings from other sources, (iii) restrictions on certain operating activities, and (iv) limitations on the payment of dividends or distributions to the Company. The Company obtained a waiver from its lender as it was not in compliance with the collateral adjustment percentage covenant at October 31, 2006. The amount available to be drawn under the facilities is a function of eligible finance receivables and inventory. Based upon eligible finance receivables and inventory at October 31, 2006, Car-Mart could draw an additional \$12.0 million under the facility.

The Company also has a \$1.2 million term loan secured by the corporate aircraft. The term loan is payable over ten years and has a fixed interest rate of 6.87%. The principal balance on this loan was \$1,173,072 at October 31, 2006.

### **G – Weighted Average Shares Outstanding**

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Weighted average shares outstanding, which are used in the calculation of basic and diluted earnings per share, are as follows:

|  | Three Months Ended<br>October 31, |            | Six Months Ended<br>October 31, |            |
|--|-----------------------------------|------------|---------------------------------|------------|
|  | 2006                              | 2005       | 2006                            | 2005       |
| Weighted average shares<br>outstanding-basic   | 11,844,101                        | 11,855,982 | 11,847,449                      | 11,850,609 |
| Dilutive options and warrants                  | -                                 | 174,926    | 122,143                         | 185,317    |
| Weighted average shares<br>outstanding-diluted | 11,844,101                        | 12,030,908 | 11,969,592                      | 12,035,926 |
| Antidilutive securities not included:          |                                   |            |                                 |            |
| Options and warrants                           | 99,750                            | 101,250    | 97,875                          | 95,625     |
| Restricted stock                               | 57,500                            | -          | 57,500                          | -          |

Common stock equivalent shares of 111,554 for options and warrants were excluded in the earnings per share calculation due to the loss in the quarter ended October 31, 2006.

## H – Commitments and Contingencies

### Related Finance Company

Car-Mart of Arkansas and Colonial do not meet the affiliation standard for filing consolidated income tax returns, and as such they file separate federal and state income tax returns. Car-Mart of Arkansas routinely sells its finance receivables to Colonial at what the Company believes to be fair market value, and is able to take a tax deduction at the time of sale for the difference between the tax basis of the receivables sold and the sales price. These types of transactions, based upon facts and circumstances, are permissible under the provisions of the Internal Revenue Code (“IRC”) as described in the Treasury Regulations. For financial accounting purposes, these transactions are eliminated in consolidation, and a deferred tax liability has been recorded for this timing difference. The sale of finance receivables from Car-Mart of Arkansas to Colonial provides certain legal protection for the Company’s finance receivables and, principally because of certain state apportionment characteristics of Colonial, also has the effect of reducing the Company’s overall effective state income tax rate by approximately 240 basis points. The actual interpretation of the Regulations is in part a facts and circumstances matter. The Company believes it satisfies the provisions of the Regulations in all material respects. Failure to satisfy those provisions could result in the loss of a tax deduction at the time the receivables are sold, and have the effect of increasing the Company’s overall effective income tax rate as well as the timing of required tax payments.

The Internal Revenue Service (“IRS”) recently concluded the previously reported examination of the Company’s consolidated income tax return for fiscal year 2002 and portions of the returns for fiscal 2003 and 2004. As a result of the examination, the IRS has questioned whether Car-Mart of Arkansas may claim certain tax losses upon the sale of its finance receivables to Colonial (as opposed to claiming the losses in a subsequent year if and when an account becomes uncollectible). The Company’s position is based upon the terms of a specific Treasury Regulation.

By letter dated July 28, 2006, the IRS delivered to the Company a revenue agent’s report (“RAR”), which proposes the disallowance of the losses in the year in which the finance receivables were sold to Colonial, plus interest and penalties. The Company intends to vigorously defend its position and on September 14, 2006, the Company filed an

administrative protest with the Appeals Office of the IRS. The protest disputes the income tax changes proposed by the IRS, as well as the penalty assertion, and requests a conference with a representative of the Appeals Office. The Company has not yet been notified by the Appeals Office of a date for the conference. If the matter is not resolved in the Appeals Office, and if the IRS intends to pursue its position, the Company will have the option of asking an appropriate court to consider the issue.

Due to the preliminary stage of the foregoing proceedings, the Company is unable to determine at the present time the amount of adjustments, if any, that may result from this examination. If a tax deficiency is ultimately assessed by the IRS and thereafter sustained, such assessment could have a material adverse effect on the Company's results of operations and financial condition, at least in the near term.

#### Litigation

In October 2006, the Company was named as a defendant in a putative class action complaint served in the District Court of Pottawatomie County, State of Oklahoma. A motion for class certification is pending. The complaint asserts that the Company charged usurious interest rates to retail customers in the State of Oklahoma for the period June 11, 2004 and forward. The Company has answered the complaint and discovery is on-going. The Company believes the complaint is without merit and intends to vigorously contest liability in this matter. Damages are unspecified and the Company cannot predict the outcome of this litigation or estimate an amount of possible loss or range of losses at this time.

**I – Supplemental Cash Flow Information**

Supplemental cash flow disclosures are as follows:

| <i>(In thousands)</i>              | Six Months Ended |        |
|------------------------------------|------------------|--------|
|                                    | 2006             | 2005   |
| Supplemental disclosures:          |                  |        |
| Interest paid                      | \$ 1,831         | \$ 963 |
| Income taxes paid, net             | 3,377            | 4,287  |
| Non-cash transactions:             |                  |        |
| Inventory acquired in repossession | 9,827            | 6,772  |

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

The following discussion should be read in conjunction with the Company’s consolidated financial statements and notes thereto appearing elsewhere in this report.

**Forward-looking Information**

The Private Securities Litigation Reform Act of 1995 provides a “safe harbor” for certain forward-looking statements. Certain information included in this Quarterly Report on Form 10-Q contains, and other materials filed or to be filed by the Company with the Securities and Exchange Commission (as well as information included in oral statements or other written statements made or to be made by the Company or its management) contain or will contain, forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended. The words “believe,” “expect,” “anticipate,” “estimate,” “project” and similar expressions identify forward-looking statements. The Company undertakes no obligation to update or revise any forward-looking statements. Such forward-looking statements are based upon management’s current plans or expectations and are subject to a number of uncertainties and risks that could significantly affect current plans, anticipated actions and the Company’s future financial condition and results. As a consequence, actual results may differ materially from those expressed in any forward-looking statements made by or on behalf of the Company as a result of various factors. Uncertainties and risks related to such forward-looking statements include, but are not limited to, those relating to the continued availability of lines of credit for the Company’s business, the Company’s ability to underwrite and collect its finance receivables effectively, assumptions relating to unit sales and gross margins, changes in interest rates, competition, dependence on existing management, adverse economic conditions (particularly in the State of Arkansas), changes in tax laws or the administration of such laws and changes in lending laws or regulations. Any forward-looking statements are made pursuant to the Private Securities Litigation Reform Act of 1995 and, as such, speak only as of the date made.

**Overview**

America’s Car-Mart, Inc., a Texas corporation (the “Company”), is the largest publicly held automotive retailer in the United States focused exclusively on the “Buy Here/Pay Here” segment of the used car market. References to the Company typically include the Company’s consolidated subsidiaries. The Company’s operations are principally conducted through its two operating subsidiaries, America’s Car-Mart, Inc., an Arkansas corporation, (“Car-Mart of Arkansas”) and Colonial Auto Finance, Inc. (“Colonial”). Collectively, Car-Mart of Arkansas and Colonial are referred to herein as “Car-Mart”. The Company primarily sells older model used vehicles and provides financing for substantially



all of its customers. Many of the Company's customers have limited financial resources and would not qualify for conventional financing as a result of limited credit histories or past credit problems. As of October 31, 2006, the Company operated 90 stores located primarily in small cities throughout the South-Central United States.

Car-Mart has been operating since 1981. Car-Mart has grown its revenues between 13% and 21% per year over the last nine full fiscal years. Growth results from same store revenue growth and the addition of new stores. Revenue growth in the first six months of fiscal 2007, as compared to the same period in the prior fiscal year, was assisted by a 7.4% increase in the average retail sales price and a 25.6% increase in interest income, offset by a 1.8% decline in the number of retail units sold.

The Company's primary focus is on collections. Each store handles its own collections with supervisory involvement of the corporate office. Over the last five full fiscal years, Car-Mart's credit losses as a percentage of sales have ranged between approximately 19% and 21% (average of 20.1%). Credit losses as a percentage of sales were 21.4% and 20.1% in fiscal years 2006 and 2005, respectively. Credit losses in the first six months of fiscal 2007 (24.8%, excluding the effect of a \$5.3 million increase in the allowance for loan losses at October 31, 2006) were higher than the Company's historical averages. Credit losses were higher due to several factors, and included higher losses experienced in most of the dealerships as the Company saw weakness in the performance of its portfolio as customers had difficulty making payments under the terms of their notes. The largest percentage increase was concentrated in the Texas dealerships. While overall credit loss percentages are much lower in mature stores (stores in existence for 10 years or more), the losses for these locations during the quarter were higher than historical averages. Credit losses, on a percentage basis, tend to be higher at new and developing stores than at mature stores. Generally, this is the case because the store management at new and developing stores tends to be less experienced (in making credit decisions and collecting customer accounts) and the customer base is less seasoned. Generally, older stores have more repeat customers. On average, repeat customers are a better credit risk than non-repeat customers. Due to the rate of the Company's growth, the percentage of new and developing stores as a percentage of total stores has been increasing over the last few years. The Company continues to believe that the most significant factor affecting credit losses is the proper execution (or lack thereof) of its business practices. The Company also believes that higher energy and fuel costs, increasing interest rates, general inflation and personal discretionary spending levels affecting its customers have had a negative impact on collection results. At October 31, 2006, 5.4% of the Company's finance receivable balances were over 30 days past due, compared to 4.1% at October 31, 2005.

The Company's gross margins as a percentage of sales have been fairly consistent from year to year. Over the last nine fiscal years, Car-Mart's gross margins as a percentage of sales have ranged between approximately 44% and 48%. Gross margins as a percentage of sales in the first six months of fiscal 2007 were 43.2%, down from 44.9% in the same period of the prior fiscal year. The Company's gross margins are set based upon the cost of the vehicle purchased, with lower-priced vehicles generally having higher gross margin percentages. Discretionary adjustments to the retail pricing guide, within a range, can and are routinely made by lot managers. The Company's gross margins have been negatively affected by higher operating costs, mostly related to increased vehicle repair costs and higher fuel costs, a higher volume and percentage of wholesale sales, which for the most part relate to cash sales of repossessed vehicles at break-even, and to a lesser extent to the increase in the average retail sales price (a function of a higher purchase price).

Hiring, training and retaining qualified associates are critical to the Company's success. The rate at which the Company adds new stores is sometimes limited by the number of trained managers the Company has at its disposal. Over the last two fiscal years, the Company has added resources to train and develop personnel. In fiscal 2007 and for the foreseeable future, the Company expects to continue to invest in the development of its workforce.

### Consolidated Operations

(Operating Statement Dollars in Thousands)

|                                     | Three Months Ended |           | % Change | As a % of Sales    |        |
|-------------------------------------|--------------------|-----------|----------|--------------------|--------|
|                                     | October 31,        |           | 2006     | Three Months Ended |        |
|                                     | 2006               | 2005      | vs.      | October 31,        |        |
|                                     |                    |           | 2005     | 2006               | 2005   |
| <b>Revenues:</b>                    |                    |           |          |                    |        |
| Sales                               | \$ 53,669          | \$ 50,581 | 6.1%     | 100.0%             | 100.0% |
| Interest income                     | 5,870              | 4,748     | 23.6     | 10.9               | 9.4    |
| Total                               | 59,539             | 55,329    | 7.6      | 110.9              | 109.4  |
| <b>Costs and expenses:</b>          |                    |           |          |                    |        |
| Cost of sales                       | 31,140             | 28,114    | 10.8%    | 58.0               | 55.6   |
| Selling, general and administrative | 10,446             | 9,610     | 8.7      | 19.5               | 19.0   |
| Provision for credit losses         | 19,848             | 12,459    | 59.0     | 37.0               | 24.6   |
| Interest expense                    | 927                | 567       | 63.5     | 1.7                | 1.1    |
| Depreciation and amortization       | 239                | 130       | 83.8     | .4                 | .3     |
| Total                               | 62,600             | 50,880    | 23.0     | 116.6              | 100.6  |
| Pretax (loss) income                | (\$ 3,061)         | \$ 4,449  | (169.0%) | (5.7%)             | 8.8%   |
| <b>Operating Data:</b>              |                    |           |          |                    |        |
| Retail units sold                   | 6,413              | 6,635     | (3.3%)   |                    |        |
| Average stores in operation         | 89.0               | 80.0      | 11.3     |                    |        |
| Average units sold per store        | 72.1               | 82.9      |          |                    |        |
| Average retail sales price          | \$ 7,957           | \$ 7,301  |          |                    |        |
| Same store revenue growth           | 1.4%               | 5.9%      |          |                    |        |
| <b>Period End Data:</b>             |                    |           |          |                    |        |
| Stores open                         | 90                 | 81        | 11.1%    |                    |        |
| Accounts over 30 days past due      | 5.4%               | 4.1%      |          |                    |        |

**Three Months Ended October 31, 2006 vs. Three Months Ended October 31, 2005**

Revenues increased \$4.2 million, or 7.6%, for the three months ended October 31, 2006 as compared to the same period in the prior fiscal year. The increase was principally the result of (i) revenue growth from stores that operated a full three months in both periods (\$.8 million, or 1.4%) and (ii) revenues from stores opened after October 31, 2005 (\$3.4 million).

Cost of sales as a percentage of sales increased 2.4% to 58.0% for the three months ended October 31, 2006 from 55.6% in the same period of the prior fiscal year. The Company's gross margins have been negatively affected by higher operating costs, mostly related to increased vehicle repair costs and higher fuel costs, a higher volume and percentage of wholesale sales, which for the most part relate to cash sales of repossessed vehicles at break-even, and to a lesser extent to the higher cost of purchases of vehicles the Company sells. The Company's selling prices are based upon the cost of the vehicle purchased, with lower-priced vehicles generally having higher gross margin percentages. Discretionary adjustments to the retail pricing guide, within a range, can and are routinely made by lot managers.

Selling, general and administrative expense as a percentage of sales was 19.5% for the three months ended October 31, 2006, an increase of .5% from the same period of the prior fiscal year. Selling, general and administrative expenses are, for the most part, more fixed in nature. The overall dollar expense met plan for the quarter; however, on a percentage basis fell short due to sales being lower than forecast. Had the Company met its internal revenue projection range, selling general and administrative expense would have been lower, on a percentage of sales basis, than for the same period in the prior year. The increase related primarily to increased advertising, higher insurance costs and additional repossession activity during the quarter. Additionally, the overall dollar increase was due, in part, to increased costs incurred to strengthen controls and improve efficiencies in the corporate infrastructure as well as incremental costs associated with the 11 new lots opened within the last 12 months. Also, approximately \$89,000 of non-cash stock-based compensation expense was recorded during the current quarter.

Provision for credit losses as a percentage of sales increased 12.4%, to 37.0% for the three months ended October 31, 2006 from 24.6% in the same period of the prior fiscal year. The increase included a \$5.3 million charge to increase the allowance for credit losses at October 31, 2006. Credit losses were higher due to several factors and included higher losses experienced in most of the dealerships as the Company saw weakness in the performance of its portfolio as customers had difficulty making payments under the terms of their loans. Credit losses, on a percentage basis, tend to be higher at new and developing stores than at mature stores. Generally, this is the case because the store management at new and developing stores tends to be less experienced (in making credit decisions and collecting customer accounts) and the customer base is less seasoned. Generally, older stores have more repeat customers. On average, repeat customers are a better credit risk than non-repeat customers. Due to the rate of the Company's growth, the percentage of new and developing stores as a percentage of total stores has been increasing over the last few years. The Company believes the most significant factor affecting credit losses is the proper execution (or lack thereof) of its business practices. The Company also believes that higher energy and fuel costs, increasing interest rates, general inflation and personal discretionary spending levels affecting customers have had a negative impact on recent collection results. The Company intends to increase the focus of store management on credit quality and collections, particularly at those stores under six years of age, and decrease the focus on sales growth at those stores. At October 31, 2006, 5.4% of the Company's finance receivable balances were over 30 days past due, compared to 4.1% at October 31, 2005.

Interest expense as a percentage of sales increased .6% to 1.7% for the three months ended October 31, 2006 from 1.1% for the same period of the prior fiscal year. The increase was attributable to higher average borrowings during the three months ended October 31, 2006 (approximately \$48.8 million) as compared to the same period in the prior fiscal year (approximately \$35.2 million), and an increase in the rate charged during the three months ended October 31, 2006 (average rate of 7.8% per annum) as compared to the same period in the prior fiscal year (average rate of 6.5% per annum). The increase in our average borrowings resulted from the growth in accounts receivable, inventory and fixed assets as well as the repurchase of common stock. The increase in interest rates is attributable to increases in the prime interest rate of the Company's lender as the Company's revolving credit facilities fluctuate with the prime interest rate of its lender.

**Consolidated Operations**  
(Operating Statement Dollars in Thousands)

|                                     | Six Months Ended<br>October 31, |            | % Change<br>2006<br>vs.<br>2005 | As a % of Sales<br>Six Months Ended<br>October 31, |        |
|-------------------------------------|---------------------------------|------------|---------------------------------|--|--------|
|                                     | 2006                            | 2005       |                                 | 2006   | 2005   |
| <b>Revenues:</b>                    |                                 |            |                                 |  |        |
| Sales                               | \$ 110,007                      | \$ 104,177 | 5.6%                            | 100.0%   | 100.0% |
| Interest income                     | 11,723                          | 9,331      | 25.6                            | 10.7   | 9.0    |
| Total                               | 121,730                         | 113,508    | 7.2                             | 110.7  | 109.0  |
| <b>Costs and expenses:</b>          |                                 |            |                                 |  |        |
| Cost of sales                       | 62,476                          | 57,375     | 8.9%                            | 56.8   | 55.1   |
| Selling, general and administrative | 20,916                          | 18,941     | 10.4                            | 19.0   | 18.2   |
| Provision for credit losses         | 32,504                          | 23,660     | 37.3                            | 29.5   | 22.7   |
| Interest expense                    | 1,829                           | 1,045      | 75.0                            | 1.7  | 1.0    |
| Depreciation and amortization       | 471                             | 278        | 69.4                            | .4   | .3     |
| Total                               | 118,195                         | 101,299    | 16.7                            | 107.4  | 97.2   |
| Pretax (loss) income                | \$ 3,535                        | \$ 12,209  | (71.0%)                         | 3.2%   | 11.7%  |
| <b>Operating Data:</b>              |                                 |            |                                 |  |        |
| Retail units sold                   | 13,280                          | 13,520     | (1.8%)                          |  |        |
| Average stores in operation         | 88.0                            | 79.5       | 10.7                            |  |        |
| Average units sold per store        | 150.9                           | 170.1      |                                 |  |        |
| Average retail sales price          | \$ 7,934                        | \$ 7,390   |                                 |  |        |
| Same store revenue growth           | 2.0%                            | 8.1%       |                                 |  |        |
| <b>Period End Data:</b>             |                                 |            |                                 |  |        |
| Stores open                         | 90                              | 81         | 11.1%                           |  |        |
| Accounts over 30 days past due      | 5.4%                            | 4.1%       |                                 |  |        |

**Six Months Ended October 31, 2006 vs. Six Months Ended October 31, 2005**

Revenues increased \$8.2 million, or 7.2%, for the six months ended October 31, 2006 as compared to the same period in the prior fiscal year. The increase was principally the result of (i) revenue growth from stores that operated a full six months in both periods (\$2.2 million, or 2.0%), (ii) revenue growth from stores opened during the six months ended October 31, 2005 or stores that opened or closed a satellite location after April 30, 2005 (\$.2 million), and (iii) revenues from stores opened after October 31, 2005 (\$5.8 million).

Cost of sales as a percentage of sales increased 1.7% to 56.8% for the six months ended October 31, 2006 from 55.1% in the same period of the prior fiscal year. The Company's gross margins have been negatively affected by higher operating costs, mostly related to increased vehicle repair costs and higher fuel costs, a higher volume and percentage of wholesale sales, which, for the most part relate to cash sales of repossessed vehicles at break-even due to the higher cost of purchases of vehicles the Company sells. The Company's selling prices are based upon the cost of the vehicle purchased, with lower-priced vehicles generally having higher gross margin percentages. Discretionary adjustments to the retail pricing guide, within a range, can and are routinely made by lot managers.

Selling, general and administrative expense as a percentage of sales was 19.0% for the six months ended October 31, 2006, an increase of .8% from the same period of the prior fiscal year. Selling, general and administrative expenses are, for the most part, more fixed in nature. The overall dollar expense met plan for the quarter; however, on a percentage basis fell short due to sales being lower than forecast. Had the Company met its internal revenue projection range, selling general and administrative expense would have been lower, on a percentage of sales basis, than for the same period in the prior year. The increase related primarily to increased advertising, higher insurance costs and additional repossession activity during the six months. Additionally, the overall dollar increase was due, in part, to increased costs incurred to strengthen controls and improve efficiencies in the corporate infrastructure as well as incremental costs associated with the eleven new lots opened within the last twelve months. Also, approximately \$190,000 of non-cash stock-based compensation expense was recorded during the current period. The above increases were offset, to an extent, by a reduction in professional fees incurred during the 2005 period in connection with completion of the Company's fiscal 2005 audit and compliance with the Sarbanes-Oxley Act of 2002.

Provision for credit losses as a percentage of sales increased 6.8%, to 29.5% for the six months ended October 31, 2006 from 22.7% in the same period of the prior fiscal year. The increase included a \$5.3 million charge to increase the allowance for credit losses at October 31, 2006. Credit losses were higher due to several factors and included higher losses experienced in most of the dealerships as the Company saw weakness in the performance of its portfolio as customers had difficulty making payments under the terms of their loans. Credit losses, on a percentage basis, tend to be higher at new and developing stores than at mature stores. Generally, this is the case because the store management at new and developing stores tends to be less experienced (in making credit decisions and collecting customer accounts) and the customer base is less seasoned. Generally, older stores have more repeat customers. On average, repeat customers are a better credit risk than non-repeat customers. Due to the rate of the Company's growth, the percentage of new and developing stores as a percentage of total stores has been increasing over the last few years. The Company believes the most significant factor affecting credit losses is the proper execution (or lack thereof) of its business practices. The Company also believes that higher energy and fuel costs, increasing interest rates, general inflation and personal discretionary spending levels affecting customers have had a negative impact on recent collection results. The Company intends to increase the focus of store management on credit quality and collections, particularly at those stores under six years of age, and decrease the focus on sales growth at those stores. At October 31, 2006, 5.4% of the Company's finance receivable balances were over 30 days past due, compared to 4.1% at October 31, 2005.

Interest expense as a percentage of sales increased .7% to 1.7% for the six months ended October 31, 2006 from 1.0% for the same period of the prior fiscal year. The increase was attributable to higher average borrowings during the six months ended October 31, 2006 (approximately \$47.5 million) as compared to the same period in the prior fiscal year (approximately \$32 million), and an increase in the rate charged during the three months ended October 31, 2006 (average rate of 7.8% per annum) as compared to the same period in the prior fiscal year (average rate of 6.5% per annum). The increase in our average borrowings resulted from the growth in finance receivables, inventory and fixed assets as well as the repurchase of common stock. The increase in interest rates is attributable to increases in the prime interest rate of the Company's lender as the Company's revolving credit facilities fluctuate with the prime interest rate of its lender.

### Financial Condition

The following table sets forth the major balance sheet accounts of the Company as of the dates specified (in thousands):

|  | October 31,<br>2006 | April 30,<br>2006 |
|--|---------------------|-------------------|
| <b>Assets:</b>                           |                     |                   |
| Finance receivables, net                 | \$ 147,512          | \$ 149,379        |
| Inventory                                | 14,713              | 10,923            |
| Property and equipment, net              | 16,233              | 15,436            |
| <b>Liabilities:</b>                      |                     |                   |
| Accounts payable and accrued liabilities | 10,271              | 11,838            |
| Debt facilities                          | 48,934              | 43,588            |

Historically, finance receivables have tended to increase from period to period slightly faster than revenue growth. This has historically been due, to a large extent, to an increasing average term necessitated by increases in the average retail sales price. In fiscal 2006, finance receivables, net grew 21.6% as compared to revenue growth of 14.4%. In fiscal 2005, finance receivables, net grew 18.7% as compared to revenue growth of 16.2%. Average months to maturity for the portfolio of finance receivables was 15 months as of October 31, 2006 compared to 16 months at October 31, 2005.

In the first six months of fiscal 2007, inventory grew by 35% as compared to revenue growth of 7.2%. Inventory grew at a faster pace than revenues as a result of the Company's decision to increase the level of inventory it carries at many of its stores to facilitate sales growth and meet competitive demands. Additionally, sales levels for the first six months of fiscal 2007, and particularly during the most recent quarter, have been below projections, resulting in additional vehicles available for sale.

Property and equipment, net increased \$.8 million during the six months ended October 31, 2006 as the Company opened three new locations and completed improvements at other existing properties.

Accounts payable and accrued liabilities decreased \$1.6 million during the six months ended October 31, 2006. The decrease was largely due to a decrease in accounts payable (\$.9 million) and a decrease in accrued compensation (.6 million). Income taxes payable decreased \$1.9 million during the six months ended October 31, 2006. The timing of payment for vehicle purchases is primarily tied to the date on which the seller presents a title for the purchased vehicle. Cash overdraft fluctuates based upon the day of the week, as daily deposits vary by day of the week and the level of checks that are outstanding at any point in time. The increase in accrued compensation costs relates to timing.

Borrowings on the Company's revolving credit facilities fluctuate based upon a number of factors including (i) net income, (ii) finance receivables growth, (iii) capital expenditures, (iv) stock repurchases and (v) income tax payments.



**Liquidity and Capital Resources**

The following table sets forth certain summarized historical information with respect to the Company's statements of cash flows (in thousands):

|  | Six Months Ended October |          |
|--|--------------------------|----------|
|  | 2006                     | 2005     |
| Operating activities:                              |                          |          |
| Net Income   | \$ 2,227                 | \$ 7,687 |
| Provision for credit losses                        | 32,504                   | 23,660   |
| Finance receivable originations                    | (100,846)                | (95,695) |
| Finance receivable collections                     | 60,735                   | 53,057   |
| Inventory  | 6,038                    | 5,370    |
| Accounts payable and accrued liabilities           | (1,567)                  | 1,781    |
| Income taxes payable                               | (1,876)                  | (209)    |
| Other  | (794)                    | 303      |
| Total  | (3,579)                  | (4,046)  |
| Investing activities:                              |                          |          |
| Purchase of property and equipment                 | (1,299)                  | (2,485)  |
| Sale of property and equipment                     | 31                       | 157      |
| Payment for business acquired                      | (460)                    | -        |
| Total  | (1,728)                  | (2,328)  |
| Financing activities:                              |                          |          |
| Exercise of stock options and related tax benefits | 164                      | 218      |
| Issuance of common stock                           | 35                       | -        |
| Purchase of common stock                           | (454)                    | (391)    |
| Debt facilities, net                               | 5,345                    | 6,408    |
| Total  | 5,090                    | 6,235    |
| Decrease in Cash                                   | \$ (217)                 | \$ (139) |

The Company generates cash flow from net income from operations. Most or all of this cash is used to fund finance receivables growth. To the extent finance receivables growth exceeds net income from operations, generally the Company increases borrowings under its credit facilities.

In general, in order to preserve capital and maintain flexibility, the Company prefers to lease the majority of the properties where its stores are located. As of October 31, 2006, the Company leased approximately 75% of its store properties. The Company expects to continue to lease; however, the Company does periodically purchase the real property where its stores are located, particularly if the Company expects to be in that location for 10 years or more.

The Company's credit facilities with its primary lender total \$60 million and consist of a combined \$50 million revolving line of credit and a \$10 million term loan. The facilities limit distributions from Car-Mart to the Company beyond (i) the repayment of an intercompany loan (\$10.0 million at October 31, 2006), and (ii) dividends equal to 75% of Car-Mart of Arkansas' net income. At October 31, 2006, the Company's assets (excluding its \$109 million equity investment in Car-Mart) consisted of \$25,000 in cash, \$3.1 million in other assets and a \$10.0 million receivable from Car-Mart. Thus, the Company is limited in the amount of dividends or other distributions it can make to its shareholders without the consent of Car-Mart's lender. Beginning in February 2003, Car-Mart assumed

substantially all of the operating costs of the Company. The Company was in violation of certain loan covenants at October 31, 2006. Waivers have been received from the Company's lenders for the violations.

At October 31, 2006 the Company had \$38 thousand of cash on hand and an additional \$12.0 million of availability under the revolving credit facilities. On a short-term basis, the Company's principal sources of liquidity include income from operations and borrowings under the revolving credit facilities. On a longer-term basis, the Company expects its principal sources of liquidity to consist of income from continuing operations and borrowings under revolving credit facilities and/or fixed interest term loans. Further, while the Company has no present plans to issue debt or equity securities, the Company believes, if necessary, it could raise additional capital through the issuance of such securities.

The Company expects to use cash to grow its finance receivables portfolio and to purchase property and equipment in the amount of approximately \$1 to \$2 million in the next 12 months in connection with refurbishing existing stores. In addition, from time to time the Company may use cash to repurchase its common stock. During the six months ended October 31, 2006, the Company repurchased 30,000 shares of its common stock for \$454,000.

The revolving credit facilities mature in April 2009. The \$10 million term loan is payable in 120 consecutive and substantially equal installments beginning June 1, 2006. The interest rate on the term loan is fixed at 7.33%. The Company expects that it will be able to renew or refinance the revolving credit facilities on or before the date they mature. The Company believes it will have adequate liquidity to satisfy its capital needs for the foreseeable future.

### **Contractual Payment Obligations**

There have been no material changes outside of the ordinary course of business in the Company's contractual payment obligations from those reported at April 30, 2006 in the Company's Annual Report on Form 10-K.

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

The Company has entered into operating leases for approximately 75% of its store and office facilities. Generally these leases are for periods of three to five years and usually contain multiple renewal options. The Company expects to continue to lease the majority of its store and office facilities under arrangements substantially consistent with the past.

Other than its operating leases, the Company is not a party to any off-balance sheet arrangement that management believes is reasonably likely to have a current or future effect on the Company's financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

### **Related Finance Company Contingency**

Car-Mart of Arkansas and Colonial do not meet the affiliation standard for filing consolidated income tax returns, and as such they file separate federal and state income tax returns. Car-Mart of Arkansas routinely sells its finance receivables to Colonial at what the Company believes to be fair market value, and is able to take a tax deduction at the time of sale for the difference between the tax basis of the receivables sold and the sales price. These types of transactions, based upon facts and circumstances, are permissible under the provisions of the Internal Revenue Code ("IRC") as described in the Treasury Regulations. For financial accounting purposes, these transactions are eliminated in consolidation, and a deferred tax liability has been recorded for this timing difference. The sale of finance receivables from Car-Mart of Arkansas to Colonial provides certain legal protection for the Company's finance receivables and, principally because of certain state apportionment characteristics of Colonial, also has the effect of reducing the Company's overall effective state income tax rate by approximately 240 basis points. The actual interpretation of the Regulations is in part a facts and circumstances matter. The Company believes it satisfies the provisions of the Regulations in all material respects. Failure to satisfy those provisions could result in the loss of a tax deduction at the time the receivables are sold, and have the effect of increasing the Company's overall effective income tax rate as well as the timing of required tax payments.

The Internal Revenue Service ("IRS") recently concluded the previously reported examination of the Company's consolidated income tax return for fiscal year 2002 and portions of the returns for fiscal 2003 and 2004. As a result of the examination, the IRS has questioned whether Car-Mart of Arkansas may claim certain tax losses upon the sale of its finance receivables to Colonial (as opposed to claiming the losses in a subsequent year if and when an account becomes uncollectible). The Company's position is based upon the terms of a specific Treasury Regulation.

By letter dated July 28, 2006, the IRS delivered to the Company a revenue agent's report ("RAR"), which proposes the disallowance of the losses in the year in which the finance receivables were sold to Colonial, plus interest and penalties. The Company intends to vigorously defend its position and on September 14, 2006, the Company filed an administrative protest with the Appeals Office of the IRS. The protest disputes the income tax changes proposed by the IRS, as well as the penalty assertion, and requests a conference with a representative of the Appeals Office. The Company has not yet been notified by the Appeals Office of a date for the conference. If the matter is not resolved in the Appeals Office, and if the IRS intends to pursue its position, the Company will have the option of asking an appropriate court to consider the issue.

Due to the preliminary stage of the foregoing proceedings, the Company is unable to determine at the present time the amount of adjustments, if any, that may result from this examination. If a tax deficiency is ultimately assessed by the

IRS and thereafter sustained, such assessment could have a material adverse effect on the Company's results of operations and financial condition, at least in the near term.

## **Critical Accounting Policies**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the Company to make estimates and assumptions in determining the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from the Company's estimates. The Company believes the most significant estimate made in the preparation of the accompanying consolidated financial statements relates to the determination of its allowance for credit losses, which is discussed below. The Company's accounting policies are discussed in Note B to the accompanying consolidated financial statements.

The Company maintains an allowance for credit losses on an aggregate basis at a level it considers sufficient to cover estimated losses in the collection of its finance receivables. The allowance for credit losses is based primarily upon historical credit loss experience, with consideration given to recent credit loss trends and changes in loan characteristics (i.e., average amount financed and term), delinquency levels, collateral values, economic conditions, underwriting and collection practices, and management's expectation of future credit losses. The allowance for credit losses is periodically reviewed by management with any changes reflected in current operations. Although it is at least reasonably possible that events or circumstances could occur in the future that are not presently foreseen which could cause actual credit losses to be materially different from the recorded allowance for credit losses, the Company believes that it has given appropriate consideration to all relevant factors and has made reasonable assumptions in determining the allowance for credit losses.

During the three month period ended October 31, 2006, management increased the allowance for credit loss percentage from 19.2% to 22% due to recent higher credit loss experience and trends. A change in accounting estimate was recognized to reflect the decision to increase the allowance for credit losses, resulting in a pretax, non-cash charge of \$5,271,000.

FASB Statement No. 154, Accounting Changes and Error Corrections - a replacement of APB Opinion No. 20 and FASB Statement No. 3 (SFAS No. 154) was issued in May 2005. SFAS No. 154 changes the requirements for the accounting for and reporting of a change in accounting principle. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of this new pronouncement in fiscal 2007 did not impact the Company's financial condition, results of operations or cash flows.

## **Recent Accounting Pronouncement**

From time to time, new accounting pronouncements are issued by the Financial Accounting Standards Board or other standard setting bodies which the Company adopts as of the specified effective date. Unless otherwise discussed, the Company believes the impact of recently issued standards which are not yet effective will not have a material impact on our consolidated financial statements upon adoption.

The Company adopted SFAS 123R effective May 1, 2006, using the modified-prospective transition method, and results for prior periods were not adjusted. Prior to adoption of SFAS 123R, the Company elected to use the intrinsic method under Accounting Principles Board Opinion No. 25, to account for its stock-based compensation arrangements. Compensation expense for stock options was recognized to the extent the market price of the underlying stock on the date of grant exceeded the exercise price of the option. SFAS 123R requires all stock-based awards to employees to be recognized in the income statement based on their fair values. SFAS 123R also requires the Company to estimate forfeitures of share-based payments upon grant and to reevaluate this estimate during the requisite service period. The Company will recognize compensation expense related to restricted stock grants over the vesting period of the underlying award in an amount equal to the fair market value of the Company's stock on the date of the grant. Restricted stock grants with only service conditions will be accounted for under the straight-line

attribution method.

For the six months ended October 31, 2006, the Company recognized total stock-based compensation expense of \$194,000 (net of an \$114,000 related income tax benefit).

As of October 31, 2006, the total compensation cost related to unvested restricted stock awards not yet recognized was \$1 million. There are no expected forfeitures. The weighted-average period over which these awards are expected to be recognized is 3.1 years.

In June 2006, the Financial Accounting Standards Board (“FASB”) issued Interpretation No. 48, “Accounting for Uncertainty in Income Taxes” (“FIN 48”), which will require companies to assess each income tax position taken using a two-step process. A determination is first made as to whether it is more likely than not that the position will be sustained, based upon the technical merits, upon examination by the taxing authorities. If the tax position is expected to meet the more likely than not criteria, the benefit recorded for the tax position equals the largest amount that is greater than 50% likely to be realized upon ultimate settlement of the respective tax position. The interpretation applies to income tax expense as well as any related interest and penalty expense.

FIN 48 requires that changes in tax positions recorded in a company’s financial statements prior to the adoption of this interpretation be recorded as an adjustment to the opening balance of retained earnings for the period of adoption. FIN 48 will generally be effective for public companies for the first fiscal year beginning after December 15, 2006. The Company anticipates adopting the provisions of this interpretation during the first quarter of fiscal 2008. No determination has yet been made regarding the materiality of the potential impact of this interpretation on the Company’s financial statements.

## Seasonality

The Company's automobile sales and finance business is seasonal in nature. The Company's third fiscal quarter (November through January) has historically been the slowest period for car and truck sales. Many of the Company's operating expenses such as administrative personnel, rent and insurance are fixed and cannot be reduced during periods of decreased sales. Conversely, the Company's fourth fiscal quarter (February through April) is historically the busiest time for car and truck sales as many of the Company's customers use income tax refunds as a down payment on the purchase of a vehicle. Further, the Company experiences seasonal fluctuations in its finance receivable credit losses. As a percentage of sales, the Company's first and fourth fiscal quarters tend to have lower credit losses (averaging 19.1% over the last five full fiscal years), while its second and third fiscal quarters tend to have higher credit losses (averaging 21.2% over the last five full fiscal years).

## Item 3. Quantitative and Qualitative Disclosures about Market Risk

The Company is exposed to market risk on its financial instruments from changes in interest rates. In particular, the Company has exposure to changes in the federal primary credit rate and the prime interest rate of its lender. The Company does not use financial instruments for trading purposes or to manage interest rate risk. The Company's earnings are impacted by its net interest income, which is the difference between the income earned on interest-bearing assets and the interest paid on interest-bearing notes payable. As described below, a decrease in market interest rates would generally have an adverse effect on the Company's profitability.

The Company's financial instruments consist of fixed rate finance receivables and fixed and variable rate notes payable. The Company's finance receivables generally bear interest at fixed rates ranging from 6% to 19%. These finance receivables generally have remaining maturities from one to 36 months. Certain of the Company's borrowings contain variable interest rates that fluctuate with market interest rates (i.e., the rate charged on the revolving credit facilities fluctuate with the prime interest rate of its lender). However, interest rates charged on finance receivables originated in the State of Arkansas are limited to the federal primary credit rate (6.25% at October 31, 2006) plus 5.0%. Typically, the Company charges interest on its Arkansas loans at or near the maximum rate allowed by law. Thus, while the interest rates charged on the Company's loans do not fluctuate once established, new loans originated in Arkansas are set at a spread above the federal primary credit rate which does fluctuate. At October 31, 2006, approximately 58% of the Company's finance receivables were originated in Arkansas. Assuming that this percentage is held constant for future loan originations, the long-term effect of decreases in the federal primary credit rate would generally have a negative effect on the profitability of the Company. This is the case because the amount of interest income lost on Arkansas originated loans would likely exceed the amount of interest expense saved on the Company's variable rate borrowings (assuming the prime interest rate of its lender decreases by the same percentage as the decrease in the federal primary credit rate). The initial impact on profitability resulting from a decrease in the federal primary credit rate and the rate charged on its variable interest rate borrowings would be positive, as the immediate interest expense savings would outweigh the loss of interest income on new loan originations. However, as the amount of new loans originated at the lower interest rate increases to an amount in excess of the amount of variable interest rate borrowings, the effect on profitability would become negative.

The table below illustrates the estimated impact that hypothetical changes in the federal primary credit rate would have on the Company's continuing pretax earnings. The calculations assume (i) the increase or decrease in the federal primary credit rate remains in effect for two years, (ii) the increase or decrease in the federal primary credit rate results in a like increase or decrease in the rate charged on the Company's variable rate borrowings, (iii) the principal amount of finance receivables (\$190 million) and variable interest rate borrowings (\$38.0 million), and the percentage of Arkansas originated finance receivables (58%), remain constant during the periods, and (iv) the Company's historical collection and charge-off experience continues throughout the periods.

| Increase (Decrease)<br>In Interest Rates | Year 1  |      | Year 2  |        |
|--|---|------|---|--------|
|  | Increase (Decrease)<br>in Pretax Earnings<br>(in thousands) |      | Increase (Decrease)<br>in Pretax Earnings<br>(in thousands) |        |
| +200 basis points                        | \$  | 127  | \$  | 1,178  |
| +100 basis points                        |   | 63   |   | 589    |
| - 100 basis points                       |   | -63  |   | -589   |
| - 200 basis points                       |   | -127 |   | -1,178 |

A similar calculation and table was prepared at April 30, 2006 and July 31, 2006. The calculation and table was comparable with the information provided above.



#### **Item 4. Controls and Procedures**

a) Evaluation of Disclosure Controls and Procedures

We completed an evaluation, under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rules 13a-15(e) and 15d-15(e) as of the end of the period covered by this report (October 31, 2006). Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is (1) recorded, processed, summarized and reported within the time periods specified in applicable rules and forms and (2) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely discussions regarding required disclosures.

b) Changes in Internal Control Over Financial Reporting

During the last fiscal quarter, there have been no changes in the Company's internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect the Company's internal controls over financial reporting.

## **PART II**

#### **Item 1. Legal Proceedings**

In October 2006, the Company was named as a defendant in a putative class action complaint served in the District Court of Pottawatomie County, State of Oklahoma. A motion for class certification is pending. The complaint asserts that the Company charged usurious interest rates to retail customers in the State of Oklahoma for the period June 11, 2004 and forward. The Company has answered the complaint and discovery is on-going. The Company believes the complaint is without merit and intends to vigorously contest liability in this matter. Damages are unspecified and the Company cannot predict the outcome of this litigation or estimate an amount of possible loss or range of losses at this time.

#### **Item 1A. Risk Factors**

Information regarding risk factors appears in the Company's MD&A under the heading "Business Risks and Forward-Looking Statements" in Part I, Item 2 of this report and in Part II, Item 7 of the Company's Fiscal 2006 Form 10-K.

The following is an update to the risk factor since the filing of the Fiscal 2006 Form 10-K.

*The Company's allowance for credit losses may not be sufficient to cover actual credit losses which could adversely affect its financial condition and operating results.*

From time to time, the Company has to recognize losses resulting from the inability of certain borrowers to repay loans and the insufficient realizable value of the collateral securing loans. The Company maintains an allowance for credit losses in an attempt to cover credit losses inherent in its loan portfolio. Additional credit losses will likely occur in the future and may occur at a rate greater than the Company has experienced to date. The allowance for credit losses is based primarily upon historical credit loss experience, with consideration given to delinquency levels, collateral values, economic conditions and underwriting and collection practices. This evaluation is inherently subjective as it requires estimates of material factors that may be susceptible to significant change. If the Company's

assumptions and judgments prove to be incorrect, its current allowance may not be sufficient and adjustments may be necessary to allow for different economic conditions or adverse developments in its loan portfolio.

During the three month period ended October 31, 2006, management increased the allowance for credit loss percentage from 19.2% to 22% due to recent higher credit loss experience and trends. A change in accounting estimate was recognized to reflect the decision to increase the allowance for credit losses, resulting in a pretax, non-cash charge of \$5,271,000.

*An unfavorable determination by the Internal Revenue Service in connection with a pending tax audit could have a material adverse effect on the Company's financial results and condition.*

Car-Mart of Arkansas and Colonial do not meet the affiliation standard for filing consolidated income tax returns, and as such they file separate federal and state income tax returns. Car-Mart of Arkansas routinely sells its finance receivables to Colonial at what the Company believes to be fair market value, and is able to take a tax deduction at the time of sale for the difference between the tax basis of the receivables sold and the sales price. These types of transactions, based upon facts and circumstances, are permissible under the provisions of the Internal Revenue Code ("IRC") as described in the Treasury Regulations. For financial accounting purposes, these transactions are eliminated in consolidation, and a deferred tax liability has been recorded for this timing difference. The sale of finance receivables from Car-Mart of Arkansas to Colonial provides certain legal protection for the Company's finance receivables and, principally because of certain state apportionment characteristics of Colonial, also has the effect of reducing the Company's overall effective state income tax rate by approximately 240 basis points. The actual interpretation of the Regulations is in part a facts and circumstances matter. The Company believes it satisfies the provisions of the Regulations in all material respects. Failure to satisfy those provisions could result in the loss of a tax deduction at the time the receivables are sold, and have the effect of increasing the Company's overall effective income tax rate as well as the timing of required tax payments.

The Internal Revenue Service (“IRS”) recently concluded the previously reported examination of the Company’s consolidated income tax return for fiscal year 2002 and portions of the returns for fiscal 2003 and 2004. As a result of the examination, the IRS has questioned whether Car-Mart of Arkansas may claim certain tax losses upon the sale of its finance receivables to Colonial (as opposed to claiming the losses in a subsequent year if and when an account becomes uncollectible). The Company’s position is based upon the terms of a specific Treasury Regulation.

By letter dated July 28, 2006, the IRS delivered to the Company a revenue agent’s report (“RAR”), which proposes the disallowance of the losses in the year in which the finance receivables were sold to Colonial, plus interest and penalties. The Company intends to vigorously defend its position and on September 14, 2006, the Company filed an administrative protest with the Appeals Office of the IRS. The protest disputes the income tax changes proposed by the IRS, as well as the penalty assertion, and requests a conference with a representative of the Appeals Office. The Company has not yet been notified by the Appeals Office of a date for the conference. If the matter is not resolved in the Appeals Office, and if the IRS intends to pursue its position, the Company will have the option of asking an appropriate court to consider the issue.

Due to the preliminary stage of the foregoing proceedings, the Company is unable to determine at the present time the amount of adjustments, if any, that may result from this examination. If a tax deficiency is ultimately assessed by the IRS and thereafter sustained, such assessment could have a material adverse effect on the Company’s results of operations and financial condition, at least in the near term.

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

The Company is authorized to repurchase up to 1 million shares of its common stock under the common stock repurchase program last approved by the Board of Directors and announced on December 2, 2005.

During the quarter ended October 31, 2006, the Company repurchased shares of the common stock under the stock repurchase program, as follows:

| Period                           | Total Number of<br>Shares<br>Purchased | Average Price<br>Paid per Share<br>(including fees) | Total Number of<br>Shares<br>Purchased as<br>Part of Publicly<br>Announced<br>Plans or<br>Programs | Maximum<br>Number of<br>Shares that May<br>Yet Be<br>Purchased<br>Under the Plans<br>or Programs |
|----------------------------------|--|---|--|--|
| August 1 through August 31       | 0                                      | \$ 0.00   | 0  | 898,750  |
| September 1 through September 30 | 10,000                                 | \$ 13.91  | 10,000   | 888,750  |
| October 1 through October 31     | 0                                      | \$ 0.00   | 0  | 888,750  |
| Total                            | 10,000                                 | \$ 13.91  | 10,000   | 888,750  |

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

The Company's 2006 annual meeting was held on October 18, 2006. The record date for such meeting was August 28, 2006 on which date there were a total of 11,895,524 shares of common stock outstanding and entitled to vote. At the meeting the Company's shareholders approved the election of directors as follows:

| Director             | Votes For  | Votes Withheld |
|----------------------|------------|----------------|
| William H. Henderson | 11,508,794 | 64,789         |
| T.J. Falgout, III    | 11,523,430 | 50,153         |
| William M. Sams      | 11,524,630 | 48,953         |
| J. David Simmons     | 10,981,517 | 592,066        |
| Carl E. Baggett      | 11,524,630 | 48,953         |
| William A. Swanston  | 11,361,468 | 212,115        |

At the Company's 2006 annual meeting, the shareholders also approved the Company's 2006 Employee Stock Purchase Plan as follows:

| Votes For | Votes Withheld |
|-----------|----------------|
| 8,622,442 | 137,447        |

**Item 6. Exhibits**

| <b>Exhibit Number</b> | <b>Description of Exhibit</b>   |
|-----------------------|---|
| 3.1                   | Articles of Incorporation of the Company (formerly SKAI, Inc.), as amended, incorporated by reference from the Company's Registration Statement on Form S-8 as filed with the Securities and Exchange Commission on November 16, 2005, File No. 333-129727, exhibits 4.1 through 4.8. |
| 3.2                   | By-Laws dated August 24, 1989, incorporated by reference from the Company's Registration Statement on Form S-8 as filed with the Securities and Exchange Commission on November 16, 2005, File No. 333-129727, exhibit 4.9.   |
| * 10.1                | Amendment to 2005 Restricted Stock Plan, effective October 12, 2005.  |
| * 31.1                | Rule 13a-14(a) certification.   |
| * 31.2                | Rule 13a-14(a) certification.   |
| * 32.1                | Section 1350 certification.   |

\*

Filed herewith.

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.

**America's Car-Mart, Inc.**

By: \s\ Tilman J. Falgout, III

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Tilman J. Falgout, III  
*Chief Executive Officer*  
*(Principal Executive Officer)*

By: \s\ Jeffrey A. Williams

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Jeffrey A. Williams  
*Chief Financial Officer and Secretary*  
*(Principal Financial and Accounting Officer)*

Dated: December 11, 2006

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**Exhibit Index**

|      |                                     |
|------|-------------------------------------|
| 10.1 | Amendment to Restricted Stock Plan. |
| 31.1 | Rule 13a-14(a) certification.       |
| 31.2 | Rule 13a-14(a) certification.       |
| 32.1 | Section 1350 certification.         |