CONNS INC
Form 10-Q
August 27, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended July 31, 2009 Commission File Number 000-50421

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

A Delaware Corporation (State or other jurisdiction of incorporation or organization)	06-1672840 (I.R.S. Employer Identification Number)

3295 College Street
Beaumont, Texas 77701
(409) 832-1696
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

NONE
(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [ ] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer [ ]	Accelerated filer [x]	Non-accelerated filer [ ]	Smaller reporting company [ ]

(Do not check if a smaller reporting company)

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of August 25, 2009:

Class	Outstanding
Common stock, $.01 par value per share	22,457,486

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Item 1. Financial Statements

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

Assets	January 31, 2009	July 31, 2009
Current assets		(unaudited)
Cash and cash equivalents	$ 11,798	$ 4,852
Other accounts receivable, net of allowance of $60 and $64, respectively	32,878	22,763
Customer accounts receivable, net of allowance of $2,338 and $4,432 respectively	61,125	115,696
Interests in securitized assets	176,543	164,090
Inventories	95,971	100,867
Deferred income taxes	13,354	14,333
Prepaid expenses and other assets	5,933	10,618
Total current assets	397,602	433,219
Long-term portion of customer accounts receivable, net of allowance of $1,575 and $2,819, respectively	41,172	73,573
Property and equipment		
Land	7,682	7,682
Buildings	12,011	13,005
Equipment and fixtures	21,670	22,336
Transportation equipment	2,646	2,725
Leasehold improvements	83,361	88,347
Subtotal	127,370	134,095
Less accumulated depreciation	(64,819)	(71,275)
Total property and equipment, net	62,551	62,820
Goodwill, net	9,617	9,617
Non-current deferred income tax asset	2,035	3,597
Other assets, net	3,652	3,545
Total assets	$ 516,629	$ 586,371
Liabilities and Stockholders' Equity		
Current liabilities		
Current portion of long-term debt	$ 5	$ 60
Accounts payable	57,809	47,708
Accrued compensation and related expenses	11,473	7,551
Accrued expenses	23,703	25,024
Income taxes payable	4,334	2,665
Deferred revenues and allowances	21,207	20,070
Total current liabilities	118,531	103,078
Long-term debt	62,912	130,235
Fair value of interest rate swaps	-	231
Deferred gains on sales of property	1,036	968
Stockholders' equity		
Preferred stock ($0.01 par value, 1,000,000 shares authorized; none issued or outstanding)	-	-
Common stock ($0.01 par value, 40,000,000 shares authorized; 24,167,445 and 24,180,692 shares issued at January 31, 2009 and July 31, 2009, respectively)	242	242

Additional paid-in capital	103,553	104,942
Accumulated other comprehensive income (loss)	-	(150)
Retained earnings	267,426	283,896
Treasury stock, at cost, 1,723,205 and 1,723,205 shares, respectively	(37,071)	(37,071)
Total stockholders' equity	334,150	351,859
Total liabilities and stockholders' equity	$ 516,629	$ 586,371

See notes to consolidated financial statements.

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

	Three Months Ended July 31,		Six Months Ended July 31,	
	2008	2009	2008	2009
Revenues				
Product sales	$ 175,240	$ 175,389	$ 355,151	$ 360,206
Service maintenance agreement commissions, net	9,911	8,858	19,881	18,648
Service revenues	5,488	6,052	10,680	11,596
Total net sales	190,639	190,299	385,712	390,450
Finance charges and other	29,105	29,821	55,657	59,606
Net (decrease) increase in fair value	(1,212)	91	(4,279)	1,481
Total finance charges and other	27,893	29,912	51,378	61,087
Total revenues	218,532	220,211	437,090	451,537
Cost and expenses				
Cost of goods sold, including warehousing and occupancy costs	136,787	140,761	275,845	286,631
Cost of parts sold, including warehousing and occupancy costs	2,264	2,797	4,594	5,384
Selling, general and administrative expense	62,900	64,867	123,268	127,492
Provision for bad debts	333	2,746	592	4,141
Total cost and expenses	202,284	211,171	404,299	423,648
Operating income	16,248	9,040	32,791	27,889
Interest (income) expense, net	(85)	942	(100)	1,528
Other (income) expense, net	128	(13)	106	(21)
Income before income taxes	16,205	8,111	32,785	26,382
Provision for income taxes	5,993	3,162	11,977	9,912
Net income	$ 10,212	$ 4,949	$ 20,808	$ 16,470
Earnings per share				
Basic	$ 0.46	$ 0.22	$ 0.93	$ 0.73
Diluted	$ 0.45	$ 0.22	$ 0.92	$ 0.73
Average common shares outstanding				

Basic	22,407	22,454	22,395	22,450
Diluted	22,620	22,660	22,591	22,675

See notes to consolidated financial statements.

Conn's, Inc.
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
Six Months Ended July 31, 2009
(unaudited)
(in thousands, except descriptive shares)

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Other Compre-hensive Income	Retained Earnings	Treasury Stock	Total
Balance January 31, 2009	24,167	$ 242	$ 103,553	$ -	$ 267,426	$ (37,071)	$ 334,150
Issuance of shares of common stock under Employee Stock Purchase Plan	13		117				117
Stock-based compensation			1,272				1,272
Net income					16,470		16,470
Adjustment of fair value of interest rate swaps net of tax of $81				(150)			(150)
Total comprehensive income							16,320
Balance July 31, 2009	24,180	$ 242	$ 104,942	$ (150)	$ 283,896	$ (37,071)	$ 351,859

See notes to consolidated financial statements.

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

	Six Months Ended July 31, 2008	Six Months Ended July 31, 2009
Cash flows from operating activities		
Net income	$ 20,808	$ 16,470
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	6,286	6,660
Amortization / (Accretion), net	(481)	525
Provision for bad debts	592	4,141
Stock-based compensation	1,721	1,272
Discounts on promotional credit	2,900	1,485
(Gains) losses on interest in securitized assets	(15,408)	(1,358)
(Increase) decrease in fair value of securitized assets	4,279	1,481
Provision for deferred income taxes	(3,904)	(1,585)
(Gains) losses on sales of property and equipment	106	(9)
Changes in operating assets and liabilities:		
Customer accounts receivable	(2,907)	(92,166)
Other accounts receivable	5,910	10,128
Interest in securitized assets	11,631	11,388
Inventory	(14,909)	(4,896)
Prepaid expenses and other assets	(3,889)	999
Accounts payable	26,525	(10,101)
Accrued expenses	3,932	(2,601)
Income taxes payable	(218)	(8,229)
Deferred revenue and allowances	3,214	(747)
Net cash provided by (used in) operating activities	46,188	(67,143)
Cash flows from investing activities		
Purchases of property and equipment	(10,825)	(6,763)
Proceeds from sales of property	57	22
Net cash used in investing activities	(10,768)	(6,741)
Cash flows from financing activities		
Proceeds from stock issued under employee benefit plans	391	117
Borrowings under lines of credit	600	198,361
Payments on lines of credit	(600)	(131,159)
Increase in deferred financing costs	-	(378)
Payment of promissory notes	(60)	(3)
Net cash provided by financing activities	331	66,938
Net change in cash	35,751	(6,946)
Cash and cash equivalents		
Beginning of the year	11,015	11,798
End of period	$ 46,766	$ 4,852
Supplemental disclosure of non-cash activity		
Cash interest received from interests in securitized assets	$ 14,917	$ 23,002
Cash proceeds from new securitizations	217,213	81,156

Cash flows from servicing fees	12,860	12,621
Purchases of property and equipment financed by notes payable	-	179

See notes to consolidated financial statements.

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Conn’s , Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)
July 31, 2009

1. Summary of Significant Accounting Policies

Basis of Presentation. The accompanying unaudited, condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. The accompanying financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair statement of the results for the interim periods presented. All such adjustments are of a normal recurring nature. Operating results for the three and six month period ended July 31, 2009, are not necessarily indicative of the results that may be expected for the fiscal year ending January 31, 2010. The financial statements should be read in conjunction with the Company’s (as defined below) audited consolidated financial statements and the notes thereto included in the Company’s Annual Report on Form 10-K filed on March 26, 2009.

The Company’s balance sheet at January 31, 2009, has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial presentation. Please see the Company’s Form 10-K for the fiscal year ended January 31, 2009, for a complete presentation of the audited financial statements at that date, together with all required footnotes, and for a complete presentation and explanation of the components and presentations of the financial statements.

Principles of Consolidation. The consolidated financial statements include the accounts of Conn’s, Inc. and all of its wholly-owned subsidiaries (the Company). All material intercompany transactions and balances have been eliminated in consolidation.

The Company enters into securitization transactions to sell eligible retail installment and revolving customer receivables and retains servicing responsibilities and subordinated interests. These securitization transactions are accounted for as sales in accordance with Statement of Financial Accounting Standards (SFAS) No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities, as amended by SFAS No. 155, Accounting for Certain Hybrid Financial Instruments, because the Company has relinquished control of the receivables. Additionally, the Company has transferred the receivables to a qualifying special purpose entity (QSPE). Accordingly, neither the transferred receivables nor the accounts of the QSPE are included in the consolidated financial statements of the Company. The Company's retained interest in the transferred receivables is valued under the requirements of SFAS No. 159, The Fair Value Option for Financial Assets and Liabilities, and SFAS No. 157, Fair Value Measurements. The Company elected the fair value option because it believes that the fair value option provides a more easily understood presentation for financial statement users. The fair value option simplifies the treatment of changes in the fair value of the asset, by reflecting all changes in the fair value of its Interests in securitized assets in current earnings, in Finance charges and other.

Fair Value of Financial Instruments. The fair value of cash and cash equivalents, receivables retained on our balance sheet, and notes and accounts payable approximate their carrying amounts because of the short maturity of these instruments. The fair value of the Company’s interests in securitized receivables is determined by estimating the present value of future expected cash flows using management’s best estimates of the key assumptions, including credit losses, forward yield curves and discount rates commensurate with the risks involved. See Note 2. The fair value of the Company’s long-term debt is determined by estimating the present value of future cash flows as if the debt were being carried at the interest rate the Company would currently incur if it were to complete a similar transaction. The fair value of the Company's long-term debt as of July 31, 2009 was approximately $125.3 million, based on the assumption that the interest spread would be approximately 200 basis points higher than the current spread in the revolving facility. The carrying amount of the long-term debt as of July 31, 2009 was approximately $130.2 million.

Use of Estimates. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. See the discussion under Note 2 regarding the changes in the inputs used in the Company's valuation of its Interests in securitized assets.

Goodwill. The Company performs an assessment annually testing for the impairment of goodwill, or at any other time when impairment indicators exist. The Company performed its annual assessment in the fourth quarter of fiscal 2009 and determined that no impairment existed. While the current market conditions have caused the Company's market capitalization to fall below its book value, the Company does not believe any indicators of impairment have occurred since the assessment was performed.

Earnings Per Share. In accordance with SFAS No. 128, Earnings per Share, the Company calculates basic earnings per share by dividing net income by the weighted average number of common shares outstanding. Diluted earnings per share include the dilutive effects of any stock options granted, as calculated under the treasury-stock method. The weighted average number of anti-dilutive stock options not included in calculating diluted EPS was 1.1 million for the three and six months ended July 31, 2008 and 1.5 million for the three and six months ended July 31, 2009.

The following table sets forth the shares outstanding for the earnings per share calculations:

	Three Months Ended July 31,	
	2008	2009
Common stock outstanding, net of treasury stock, beginning of period	22,401,836	22,452,045
Weighted average common stock issued in stock option exercises	3,696	-
Weighted average common stock issued to employee stock purchase plan	1,587	1,893
Shares used in computing basic earnings per share	22,407,119	22,453,938
Dilutive effect of stock options, net of assumed repurchase of treasury stock	213,300	206,360
Shares used in computing diluted earnings per share	22,620,419	22,660,298

	Six Months Ended July 31,	
	2008	2009
Common stock outstanding, net of treasury stock, beginning of period	22,374,966	22,444,240
Weighted average common stock issued in stock option exercises	16,170	-
Weighted average common stock issued to employee stock purchase plan	3,755	6,247
Shares used in computing basic earnings per share	22,394,891	22,450,487
Dilutive effect of stock options, net of assumed repurchase of treasury stock	195,665	224,085
Shares used in computing diluted earnings per share	22,590,556	22,674,572

Adoption of New Accounting Pronouncements. On February 1, 2009, the Company was required to adopt SFAS 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133. This statement is intended to improve transparency in financial reporting by requiring enhanced disclosures of an entity's derivative instruments and hedging activities and their effects on the entity's financial position, financial performance, and cash flows. SFAS 161 applies to all derivative instruments within the scope of SFAS 133, as well as related hedged items, bifurcated derivatives, and non-derivative instruments that are designated and qualify as hedging instruments. FAS 161 only impacts disclosure requirements and therefore will not have an impact on the Company's financial position, financial performance or cash flows. The required disclosures have been included in Note 5 to the financial statements.

In April 2009, the FASB issued FSP FAS 107-1 and Accounting Principles Board ("APB") Opinion No. 28-1 (collectively, "FSP FAS 107-1"), Interim Disclosures about Fair Value of Financial Instruments. FSP FAS 107-1 amends SFAS No. 107, Disclosures about Fair Value of Financial Instruments, to require an entity to provide disclosures about fair value of financial instruments in interim financial information. The FSP FAS 107-1 also amends APB Opinion No. 28, Interim Financial Reporting, to require those disclosures about the fair value of financial instruments in summarized financial information at interim reporting periods. Under FSP FAS 107-1, the Company will be required to include disclosures about the fair value of its financial instruments whenever it issues financial information for interim reporting periods. In addition, the Company will be required to disclose in the body or in the accompanying notes of its summarized financial information for interim reporting periods and in its financial statements for annual reporting periods, the fair value of all financial instruments for which it is practicable to estimate that value, whether recognized or not recognized in the statement of financial position. The Company adopted the provisions of FSP FAS 107-1 which became effective for periods ending after June 15, 2009.

In May 2009, the FASB issued SFAS No. 165, Subsequent Events, which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The Company adopted the provisions of SFAS No. 165, which became effective for interim and annual reporting periods ending after June 15, 2009. Subsequent events have been evaluated through the date and time the financial statements were issued on August 27, 2009. No material subsequent events have occurred since July 31, 2009 that required recognition or disclosure in the Company's current period financial statements.

Recently Issued Accounting Pronouncements.

In June 2009, the FASB issued SFAS No. 166, "Accounting for Transfers of Financial Assets – an amendment of FASB Statement No. 140" ("SAS 166"). SFAS 166 revises SFAS No. 140 to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets. After the effective date, the concept of a qualifying special-purpose entity will no longer be relevant for accounting purposes. Therefore, formerly qualifying special-purpose entities (as defined under previous accounting standards) should be evaluated for consolidation by reporting entities on and after the effective date in accordance with the applicable consolidation guidance. If the evaluation on the effective date results in consolidation, the reporting entity should apply the transition guidance provided in the pronouncement that requires consolidation. SFAS 166 is effective for fiscal years beginning after November 15, 2009. The Company is currently evaluating the impact that the adoption of SFAS 166 will have on its consolidated financial statements as it relates to its qualifying special purpose entity.

In June 2009, the FASB issued SFAS No. 167, "Amendments to FASB Interpretation No. 46(R)" ("SFAS 167"). SFAS 167 amends certain requirements of FASB Interpretation No. 46(R) to improve financial reporting by companies involved with variable interest entities and to provide more relevant and reliable information to users of financial statements. This Statement amends Interpretation 46(R) to require an enterprise to perform an analysis to determine whether the enterprise's variable interest or interests give it a controlling financial interest in a variable interest entity. This analysis identifies the primary beneficiary of a variable interest entity as the enterprise that has both of the following characteristics:

a. The power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance

b. The obligation to absorb losses of the entity that could potentially be significant to the variable interest entity or the right to receive benefits from the entity that could potentially be significant to the variable interest entity.

SFAS 167 is effective for fiscal years beginning after November 15, 2009. The Company is currently evaluating the impact that the adoption of SFAS 167 will have on its consolidated financial statements, specifically as it relates to its qualifying special purpose entity.

In June 2009, the FASB issued SFAS No. 168, "The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles, a replacement of FASB Statement No. 162" ("FAS 168"). The standard establishes the FASB Accounting Standards Codification™ (the "Codification") as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP, and is intended to simplify user access to all authoritative GAAP by providing all the authoritative literature related to a particular topic in one place. The Codification is effective for interim and annual periods ending after September 15, 2009, and as of the effective date, all existing accounting standard documents will be superseded. The Codification is effective for the Company for the third quarter of the fiscal year ended January 31, 2010, and accordingly, the Company's Quarterly Report on Form 10-Q for the quarter ending October 31, 2009, and all subsequent public filings will reference the Codification as the sole source of authoritative literature.

2. Fair Value of Interests in Securitized Assets

The Company estimates the fair value of its Interests in securitized assets using a discounted cash flow model with most of the inputs used being unobservable inputs. The primary unobservable inputs, which are derived principally from the Company's historical experience, with input from its investment bankers and financial advisors, include the estimated portfolio yield, credit loss rate, discount rate and payment rate and reflect the Company's judgments about the assumptions market participants would use in determining fair value. In determining the cost of borrowings, the Company uses current actual borrowing rates, and adjusts them, as appropriate, using interest rate futures data from market sources to project interest rates over time. Changes in the inputs over time, including varying credit portfolio performance, market interest rate changes, market participant risk premiums required, or a shift in the mix of funding sources, could result in significant volatility in the fair value of the Interest in securitized assets, and thus the earnings of the Company.

For the three and six months ended July 31, 2009, Finance charges and other included a non-cash increase in the fair value our Interests in securitized assets of $0.1 million and $1.5 million, respectively, reflecting primarily a lower risk premium included in the discount rate inputs during the six months ended July 31, 2009. Based on a review of the changes in market risk premiums during the six months ended July 31, 2009, and discussions with its investment bankers and financial advisors, the Company estimated that a market participant would require a risk premium that was approximately 200 basis points less than was utilized at April 30, 2009, and 450 basis points less than was utilized at January 31, 2009. As a result, the Company decreased the weighted average discount rate input from 30.0% at January 31, 2009 to 27.4% at April 30, 2009, and to 25.5% at July 31, 2009, after reflecting a 2 basis point decrease in the risk-free interest rate included in the discount rate input at April 30, 2009, and a further 1 basis point decrease at July 31, 2009. These changes, partially offset by changes in the funding mix inputs utilized and other input changes which decreased the fair value, resulted in an increase in fair value for the six month period ended July 31, 2009 (see reconciliation of the balance of interests in securitized assets below). The changes in fair value resulted in an increase in Income before taxes of $0.1 million and $1.5 million, an increase in net income of $0.1 million and $1.0 million for the three and six months ended July 31, 2009, respectively, and an increase in basic and diluted earnings per share of $0.04 for the six months ended July 31, 2009.

If a market participant were to require a return on investment that is 10% higher than estimated in the Company's calculation, the fair value of its interest in securitized assets would be decreased by $3.8 million as of July 31, 2009. The Company will continue to monitor financial market conditions and, each quarter, as it reassesses the inputs used, may adjust its inputs up or down, including the risk premiums it estimates a market participant would use. As the financial markets and general economic conditions fluctuate, the Company will likely be required to record additional non-cash gains and losses in future periods.

The following is a reconciliation of the beginning and ending balances of the Interests in securitized assets and the beginning and ending balances of the servicing liability for the three months ended July 31, 2008 and 2009 (in thousands):

	Three Months Ended July 31,			
		2008		2009
Reconciliation of Interests in Securitized Assets:				
Balance of Interests in securitized assets at beginning of period	$	168,900	$	170,602
Amounts recorded in Finance charges and other:				
Gains associated with changes in portfolio balances		15		416
Changes in fair value due to assumption changes:				
Fair value increase (decrease) due to changing portfolio yield		(119)		(469)
Fair value increase (decrease) due to lower (higher) projected interest rates		(1,036)		(324)
Fair value increase (decrease) due to changes in funding mix		198		(2,200)
Fair value increase (decrease) due to change in risk-free interest rate component of discount rate		(686)		12
Fair value increase (decrease) due to change in risk premium included in discount rate		-		2,830
Other changes		491		(227)
Net change in fair value due to assumption changes		(1,152)		(378)
Net Gains (Losses) included in Finance charges and other (a)		(1,137)		38
Change in balance of subordinated security and equity interest due to transfers of receivables		9,885		(6,550)
Balance of Interests in securitized assets at end of period	$	177,648	$	164,090
Reconciliation of Servicing Liability:				
Balance of servicing liability at beginning of period	$	1,204	$	1,038
	&#16			