

CONNS INC
Form 10-K
March 25, 2010

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

Form 10-K
Annual Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

For the fiscal year ended January 31, 2010

Commission File Number 000-50421

CONN'S, INC.
(Exact Name of Registrant as Specified in its Charter)

A Delaware corporation
(State or other jurisdiction of incorporation or
organization)

06-1672840
(I.R.S. Employer Identification Number)

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

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

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

Title of Each Class	Name of Exchange on Which Registered
Common Stock, par value \$0.01 per share	The NASDAQ Global Select Market, Inc

Securities registered pursuant to Section 12(g) of the Act:
NONE

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

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

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

10-K.

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

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates as of July 31, 2009, was approximately \$183.4 million based on the closing price of the registrant’s common stock as reported on the NASDAQ Global Select Market, Inc.

There were 22,457,486 shares of common stock, \$0.01 par value per share, outstanding on July 31, 2010.

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the Definitive Proxy Statement for the Annual Meeting of Stockholders to be held May 25, 2010 (incorporated herein by reference in Part III).

TABLE OF CONTENTS

	Page
<u>PART I</u>	
<u>ITEM 1. BUSINESS.</u>	3
<u>ITEM 1A. RISK FACTORS.</u>	20
<u>ITEM 1B. UNRESOLVED STAFF COMMENTS.</u>	29
<u>ITEM 2. PROPERTIES.</u>	29
<u>ITEM 3. LEGAL PROCEEDINGS.</u>	30
<u>PART II</u>	
<u>ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, AND RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.</u>	30
<u>ITEM 6. SELECTED FINANCIAL DATA.</u>	31
<u>ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.</u>	32
<u>ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.</u>	59
<u>ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.</u>	60
<u>ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.</u>	90
<u>ITEM 9A. CONTROLS AND PROCEDURES</u>	91
<u>ITEM 9B. OTHER INFORMATION</u>	91
<u>PART III</u>	
<u>ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE</u>	92
<u>ITEM 11. EXECUTIVE COMPENSATION</u>	92
<u>ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS</u>	92
<u>ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE</u>	92
<u>ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES</u>	92
<u>PART IV</u>	
<u>ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.</u>	93
<u>SIGNATURES</u>	94
<u>EXHIBIT INDEX</u>	95

PART I

ITEM 1. BUSINESS.

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

Overview

We are a specialty retailer and provider of consumer finance for purchases of a variety of durable consumer products for the home. We offer over 3,000 product items, or SKUs, at good-better-best price points in our core product categories of:

- Consumer Electronics, which includes LED, LCD, plasma and DLP televisions, camcorders, digital cameras, computers and computer accessories, Blu-ray and DVD players, video game equipment, portable audio, MP3 players, GPS devices and home theater products. We represent such brands as Samsung, Sony, LG, Toshiba, Hewlett Packard, Panasonic, Mitsubishi, Compaq, Bose, Canon and JVC. Based on 2008 revenues, as reported in *Twice*, This Week in Consumer Electronics, we were the 33rd largest retailer of consumer electronics in the United States;
- Home Appliances, which includes refrigerators, freezers, washers, dryers, dishwashers, ranges and room air conditioners. We represent such brands as Whirlpool, Maytag, Frigidaire, Kitchen Aid, Samsung, LG, General Electric and Friedrich. Based on 2008 revenues, as reported in *Twice*, we were the 9th largest retailer of home appliances in the United States;
- Furniture and Mattresses, which includes living room, bedroom and dining room furniture. We represent such brands as Serta, Lady Americana, Better Homes and Gardens, Ashley, Lane, Broyhill, Franklin and Jackson Furniture; and
- Lawn and Garden Equipment, which includes lawn mowers, lawn tractors and handheld equipment. We represent such brands as Poulan, Husqvarna and Toro.

We sell our products for cash or for payment through major credit cards, in addition to offering our customers several financing alternatives through our proprietary credit programs and third-party financing. In the last three fiscal years, we financed, on average, approximately 61% of our retail sales through one of our two credit programs. We offer our customers a choice of installment payment plans and revolving credit plans through our primary credit portfolio. We also offer an installment program through our secondary credit portfolio to a limited number of customers who do not qualify for credit under our primary credit portfolio. Additionally, the most credit worthy customers in our primary credit portfolio may be eligible for no-interest financing plans.

We began as a small plumbing and heating business in 1890. We began selling home appliances to the retail market in 1937 through one store located in Beaumont, Texas. We opened our second store in 1959 and have since grown to 76 stores. We have been known for providing excellent customer service for over 119 years. We believe that our customer-focused business strategies make us an attractive alternative to appliance and electronics superstores, department stores and other national, regional and local retailers. We strive to provide our customers with:

- a broad range of competitively priced, customer-driven, brand name products;
- flexible financing alternatives through our proprietary credit programs and third-party financing;
- next day delivery capabilities;

- outstanding product repair service;
- highly trained and knowledgeable sales personnel; and
- a high level of customer service.

We believe that these strategies drive repeat purchases and enable us to generate substantial brand name recognition and customer loyalty. During fiscal 2010, approximately 67.5% of our credit customers, based on the number of invoices written, were repeat customers.

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

- we have grown from 26 stores to 76 stores, an increase of over 192%, and although we have no new store openings currently planned, we plan to continue our store development in the future, dependent on capital availability to fund the expansion of our consumer finance operations;
- total revenues have grown 257%, at a compounded annual rate of 12.3%, from \$234.5 million in fiscal 1999, to \$836.7 million in fiscal 2010 and our same store sales growth from fiscal 1999 through fiscal 2010 has averaged 5.7%; it decreased by 13.8% for fiscal 2010;
- our operating margin has averaged 8.0% since fiscal 1999, including the impacts of the non-cash fair value adjustments recorded during fiscal years 2009 and 2010; it was 2.9% for fiscal 2010; and
- our consumer credit portfolio has grown 356.3%, at a compounded annual growth rate of 14.8%, from \$161.3 million at July 31, 1999 to \$736.0 million at January 31, 2010.

See additional discussion about our operations under Management's Discussion and Analysis of Financial Condition and Results of Operations.

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

Industry Overview

As measured by Twice, the top 100 consumer electronics retailers in the United States reported equipment and software sales of \$126.2 billion in 2008, a 1.0% increase from the \$124.9 billion reported in 2007. According to the Consumer Electronics Association, or CEA, total industry manufacturer sales of consumer electronics products in the world, are projected to be \$165.3 billion in 2010, up 0.3% from \$164.9 billion in 2009. The consumer electronics market is highly fragmented with sales coming from large appliance and electronics superstores, national chains, small regional chains, single-store operators, and consumer electronics departments of selected department and discount stores. We estimate, based on data provided in Twice, that Best Buy and Circuit City, the two largest consumer electronics superstore chains together accounted for approximately 38% of the total electronics sales attributable to the 100 largest retailers in 2008. Based on revenue in 2008, we were the 33rd largest retailer of consumer electronics in the United States.

Technological advancements and the introduction of new products have largely driven growth in the consumer electronics market. Recently, industry growth has been fueled primarily by the introduction of products that incorporate digital technology, such as high definition flat-panel (including LED and new 3-D technology) and projection televisions, Blu-ray and traditional DVD players, digital cameras and camcorders, digital stereo receivers,

satellite technology and MP3 products. Digital products offer significant advantages over their analog counterparts, including better clarity and quality of video and audio, durability of recording and compatibility with computers. Due to these advantages, we believe that digital technology will continue to drive industry growth.

Based on data published in Twice the top 100 major appliance retailers reported sales of approximately \$22.8 billion in 2008, down approximately 1.0% from reported sales in 2007 of approximately \$23.8 billion. The retail appliance market is large and concentrated among a few major dealers, with sales coming primarily from large appliance and electronics superstores, national chains, small regional chains and home improvement centers. Sears has been the leader in the retail appliance market, with a market share of the top 100 retailers of approximately 34% in 2008 and 35% in 2007. Lowe's and Home Depot held the second and third place positions, respectively, in national market share in 2008. Based on revenue in 2008, we were the 9th largest retailer of home appliances in the United States.

In the home appliance market, many factors impact sales, including consumer confidence, economic conditions, household formations and new product introductions. Product design and innovation have recently been a key driver of sales in this market, while the reduction in sales of homes has negatively impacted appliance sales. Products recently introduced include high efficiency, front-loading laundry appliances and three door refrigerators, and variations on these products, including new features.

According to the U.S. Department of Commerce – Bureau of Economic Analysis, personal consumption expenditures for household furniture and mattresses were estimated to be approximately \$85.8 billion in 2009, down from \$92.8 billion in the prior year. Industry projections estimate that retail household furniture and mattress sales will grow approximately 3% to 5% annually from 2008 through 2013. The household furniture and mattress market is highly fragmented with sales coming from manufacturer-owned stores, independent dealers, furniture centers, specialty sleep product stores, national and local chains, mass market retailers, department stores and, to a lesser extent, home improvement centers, decorator showrooms, wholesale clubs, catalog retailers, and the Internet.

Based on data from the Federal Reserve System, estimated total consumer credit outstanding, which excludes primarily loans secured by real estate, was \$2.45 trillion as of December 31, 2009, down 4.3% from \$2.56 trillion at December 31, 2008. As a result of the recession that began in late 2007, consumers have increased their rate of savings and reduced their level of borrowing to fund purchases. Consumers obtain credit from banks, credit unions, finance companies and non-financial businesses that offer credit, including retailers. The credit obtained takes many forms, including revolving (e.g. credit cards) or fixed-term (automobile loans) credit, and at times is secured by the products being purchased.

Business Strategy

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

- Offering a broad range of customer-driven, brand name products. We offer a comprehensive selection of high-quality, brand name merchandise to our customers at guaranteed low prices. Consistent with our good-better-best merchandising strategy, we offer a wide range of product selections from entry-level models through high-end models. We maintain strong relationships with the approximately 200 manufacturers and distributors that enable us to offer over 3,000 SKUs to our customers. Our principal suppliers include General Electric, Whirlpool, Frigidaire, Maytag, LG, Mitsubishi, Samsung, Sony, Toshiba, Serta, Ashley, Bose, Friedrich, Lane, Broyhill, Hewlett Packard, Compaq, Panasonic, Poulan, Husqvarna and Toro.
- Offering flexible financing alternatives through our proprietary credit programs. In the last three years, we financed, on average, approximately 61% of our retail sales through our internal credit programs. We believe that our credit programs provide our customers access to financing alternatives that our competitors typically do not offer and, as a result they:
 - expand our potential customer base,
 - increase our sales revenue,
 - enhance customer loyalty, and
 - enhance our overall profitability through consistent earnings from financing income.

Our credit department makes all credit decisions internally, entirely independent of our sales personnel. We provide special consideration to customers with good credit history with us. Before extending credit, we consider our loss experience by product category and the customer's credit worthiness and income to debt level in determining the down payment amount and other credit terms. This facilitates product sales while keeping our credit risk within an acceptable range, allowing us to generate consistent credit portfolio performance. We provide a full range of credit products, including interest-free programs for the highest credit quality customers and our secondary portfolio for our credit-challenged customers. The secondary portfolio, which has generally lower average credit scores than our primary portfolio, undergoes more intense internal underwriting scrutiny to mitigate the inherently greater risk, including address and employment verification and reference checks. Approximately 60% of our customers who have active credit accounts with us take advantage of our in-store payment option and come to our stores each month to make their payments, which we believe results in additional sales to these customers. We may be required in connection with our recently amended ABS credit facility to reduce or eliminate in-store payment options, dependent on certain criteria. We employ a rigorous series of measures to ensure collection of our credit receivables including contacting customers with past due accounts daily and attempt to work with them to collect payments in times of financial difficulty or periods of economic downturn. Our experience in credit underwriting and the collections process has enabled us to achieve an average net loss ratio of 3.3% over the past three years on the credit portfolio that we manage, including receivables transferred to our Qualifying Special Purpose Entity or QSPE.

- Maintaining next day distribution capabilities. We maintain four regional distribution centers and three other related facilities that, in combination with an outsourced third-party distribution arrangement in Louisiana, cover all of the major markets in which we operate. These facilities are part of a sophisticated inventory management system that also includes a fleet of approximately 70 transfer and delivery vehicles that service all of our markets. Our distribution operations enable us to deliver products on the day after the sale for approximately 94% of our customers who scheduled delivery during that timeframe.
- Providing outstanding product repair service. We service every product that we sell, and we service only the products that we sell. In this way, we can assure our customers that they will receive our service technicians' exclusive attention to their product repair needs. All of our service centers are authorized factory service facilities that provide trained technicians to offer in-home diagnostic and repair service utilizing a fleet of approximately 120 service vehicles as well as on-site service and repairs for products that cannot be repaired in the customer's home. At times, we also use third-party service providers to allow us to cover some of the markets outside our traditional service areas and maintain the appropriate level of customer service.
- Developing and retaining highly trained and knowledgeable personnel. We require all sales personnel to complete an intensive classroom training program and additional time riding in a delivery truck and a service truck to observe how we serve our customers after the sale is made. After the initial new hire training, all sales personnel participate in regular training programs to learn about new products and refresh their knowledge of the general sales process and maintaining a high level of customer service. Additionally, we also require all credit personnel to complete a two week classroom training program. Classroom instruction includes negotiation techniques and credit policy training to ensure customer retention and compliance with debt collection regulations. Post graduation, the collection trainees undergo additional skill set assessment training, coaching, and call monitoring within their respective department assignments. All credit personnel are required to complete monthly and quarterly refresher training and testing.
- Providing a high level of customer service. We endeavor to maintain a very high level of customer service as a key component of our culture, which has resulted in average customer satisfaction levels of approximately 90% over the past three years. We measure customer satisfaction on the sales floor, in our delivery operation and in our service department by sending survey cards to all customers to whom we have delivered or installed a product or made a service call. Our customer service resolution department takes more than 18,000 calls or online requests for assistance each month and attempts to assist customers within 72 hours of contact.

Store Development and Growth Strategy

In addition to executing our business strategy, we intend to continue to achieve profitable, controlled growth by increasing same store sales, and updating, expanding or relocating our existing stores, and although we have no new store openings planned currently, continuing our new store development in the future, dependent on future capital availability.

- Increasing same store sales. We plan to continue to increase our same store sales by:

- continuing to offer quality products at competitive prices;
- re-merchandising our product offerings in response to changes in consumer interest and demand;
- adding new merchandise to our existing product lines;

- training our sales personnel to increase sales closing rates;
 - updating our stores as needed;
 - continuing to provide a high level of customer service in sales, delivery and servicing of our products; and
 - increasing sales of our merchandise, finance products, repair service agreements and credit insurance through direct mail and in-store credit promotion programs.
- Opening new stores. While we currently have no plans to open any new stores or to update existing stores for fiscal 2011, we intend to take advantage of our reliable infrastructure and proven store model to open new stores in the future, dependent upon future capital availability. This infrastructure includes our proprietary management information systems, training processes, distribution network, merchandising capabilities, supplier relationships, product service capabilities and centralized credit approval and collection management processes. We intend to expand our store base in existing, adjacent and new markets, as follows:
 - Existing and adjacent markets. Over the long-term, we intend to increase our market presence by opening new stores in our existing markets and in adjacent markets as we identify the need and opportunity. New store openings in these locations will allow us to maximize opportunity in those markets and leverage our existing distribution network, advertising presence, brand name recognition and reputation. In fiscal 2010, we opened one new store in each of Dallas and Houston.
 - New markets. During fiscal 2008 we opened our first store in Oklahoma and opened two additional stores in the market during fiscal 2009. We intend to consider new markets over the next several fiscal years, beginning with markets in states in which we currently operate. We expect that new store growth will include major metropolitan markets in Texas and have also identified a number of smaller markets within Texas, Louisiana and Oklahoma in which we expect to explore new store opportunities. Our long-term growth plans include markets in other areas of significant population density in neighboring states.
 - Updating, expanding or relocating existing stores. Over the last three years, we have updated, expanded or relocated many of our stores. We continue to update our prototype store model and implement it at new locations and in existing locations in which the market demands support the required design changes. As we continue to add new stores or update or replace existing stores, we intend to modify our floor plan to include elements of this new model. We continuously evaluate our existing and potential sites to ensure our stores are in the best possible locations and relocate stores that are not properly positioned. We typically lease rather than purchase our stores to retain the flexibility of managing our financial commitment to a location if we later decide that the store is performing below our standards or the market would be better served by a relocation. After updating, expanding or relocating a store, we expect to increase same store sales at the store.

The addition of new stores and new and expanded product categories have played a significant role in our continued growth and success. We currently operate 76 retail stores located in Texas, Louisiana and Oklahoma. We opened

seven stores in each of fiscal 2008 and 2009 and two stores in fiscal 2010. Additionally, we closed two of our clearance center locations in fiscal 2010. While we currently have no plans to open any new stores or to update existing stores for fiscal 2011, we expect to continue our store development program in the future, with a long-range plan of increasing the store count by approximately 10% each year, and to update a portion of our existing stores each year, dependent upon capital availability. We believe that continuing our strategies of updating existing stores, growing our store base and locating our stores in desirable geographic markets is important to our future success.

Customers

We do not have a significant concentration of sales with any individual customer and, therefore, the loss of any one customer would not have a material impact on our business. No single customer accounts for more than 10% of our total revenues; in fact, no single customer accounted for more than \$250,000 during the year ended January 31, 2010.

Products and Merchandising

Product Categories. Each of our stores sells the major categories of products shown below. The following table, which has been adjusted from previous filings to ensure comparability, presents a summary of total revenues for the years ended January 31, 2008, 2009, and 2010:

	2008		Year Ended January 31,			
	Amount	%	2009		2010	
			Amount	%	Amount	%
	(in thousands)					
Consumer electronics	\$244,872	29.7	% \$305,056	34.2	% \$262,751	31.4
Home appliances	223,877	27.2	221,474	24.9	208,470	24.9
Track	101,289	12.3	109,799	12.3	97,463	11.6
Furniture and mattresses	62,797	7.6	68,869	7.7	68,208	8.2
Lawn and garden	20,914	2.5	21,132	2.4	14,694	1.8
Delivery	12,524	1.5	12,423			