

CONNS INC  
Form 10-K/A  
September 15, 2006

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

**Form 10-K/A  
(AMENDMENT NO. 1)**

**Annual Report Pursuant to Section 13 or 15(d)  
of the Securities Exchange Act of 1934**

For the fiscal year ended January 31, 2006

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:

**NONE**

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

Title of Class

**Common Stock, Par Value \$0.01 Per Share**

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.

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

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates as of July 29, 2005 was approximately \$180,604,464 based on the closing price of the registrant’s common stock as reported on the NASDAQ National Market.

There were 23,571,564 shares of common stock, \$0.01 par value per share, outstanding on March 27, 2006.

**DOCUMENTS INCORPORATED BY REFERENCE:**

Portions of the Definitive Proxy Statement for the Annual Meeting of Stockholders to be held May 31, 2006 (incorporated herein by reference in Part III).

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## EXPLANATORY NOTE

### Restatement of Consolidated Financial Statements

We are amending our Annual Report on Form 10-K (the “Original Filing”) for the year ended January 31, 2006, to restate our consolidated financial statements for the years ended January 31, 2006, 2005 and 2004 and the related disclosures. This Form 10-K/A also includes the restatement of selected financial data as of and for the years ended January 31, 2006, 2005, 2004, 2003, and July 31, 2001, the six months ended January 31, 2002 and the twelve months ended January 31, 2002, included in Item 6, and certain of the financial information presented in Item 7 - Management’s Discussion and Analysis of Financial Condition and Results of Operations. See Note 13 to the consolidated financial statements for a summary of the restated amounts.

On September 8, 2006, we concluded that our consolidated financial statements for the years ended January 31, 2006, 2005 and 2004 as well as the selected financial data for the years ended January 31, 2006, 2005, 2004, 2003, and July 31, 2001, the six months ended January 31, 2002 and the twelve months ended January 31, 2002, should be restated to correct for errors in recording interests in securitized assets, securitization income and related income tax impacts that were incorrectly accounted for under U.S. generally accepted accounting principles, specifically covered by Statement of Financial Accounting Standards (“SFAS”) No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities* and Emerging Issues Task Force (“EITF”) No. 99-20, *Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interest in Securitized Financial Assets*. Our decision to restate our consolidated financial statements and certain related and selected financial information for the stated years and periods was based on the results of an internal review of our accounting for the fair value of our retained interest asset performed under the direction of the Audit Committee of the Board of Directors.

During the preparation of our consolidated financial statements for the quarter ended July 31, 2006, we identified an issue related to the recording of securitization income. Based on our discovery and the results of discussions with our independent accountants and the Audit Committee of the Board of Directors, it was determined that a review of our accounting under SFAS No. 140 should be completed before the statements for the quarter ended July 31, 2006 were issued. The internal review revealed that we had incorrectly reduced securitization income and the value of our interests in securitized assets by the amount of future expected loan losses recorded on the books of the qualifying special purpose entity that owns the receivables.

As a result of the error discussed above and the resulting restatement, management has concluded that a material weakness in its internal controls over financial reporting existed. Specifically, controls were not operating effectively to ensure that the proper accounting and corresponding consolidated financial statement presentation of securitization income and the fair value of interests in securitized assets was consistent with SFAS No. 140. As a result of this material weakness, we concluded that our disclosure controls and procedures were not effective as of January 31, 2006.

We believe we have taken the steps necessary to remediate this material weakness relating to our accounting under SFAS No. 140 and related processes, procedures, and controls; however, we cannot confirm the effectiveness of our enhanced internal controls with respect to our accounting under SFAS No. 140 until we and our independent auditors have conducted sufficient tests. Accordingly, we will continue to monitor the effectiveness of the processes, procedures, and controls we have implemented and will make any further changes management determines appropriate.

We have not amended and do not anticipate amending our Annual Reports on Form 10-K for any years prior to January 31, 2006. With the exception of our Form 10-Q for the quarter ended April 30, 2006, we will not be amending any of our Quarterly Reports on Form 10-Q. We have filed today the Form 10-Q/A for the quarter ended April 30, 2006 amending the Quarterly Report on Form 10-Q previously filed. The financial information that has been

previously filed or otherwise reported for these periods is superseded by the financial information in this Annual Report on Form 10-K/A and the Quarterly Report on Form 10-Q/A. Accordingly, the consolidated financial statements and related financial information contained in those previously filed Annual Report on Form 10-K and Quarterly Report on Form 10-Q should no longer be relied upon.

All of the information in this Form 10-K/A is as of January 31, 2006 and does not reflect any subsequent information or events other than the restatement and related matters discussed in Note 13. Only the following items have been amended as a result of the restatement:

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Part I - Item 1 - Business;

Part II - Item 6 - Selected Financial Data;

Part II - Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations;

Part II - Item 8 - Financial Statements and Supplementary Data;

Part II - Item 9A - Controls and Procedures

Part IV - Item 15 - Exhibits and Financial Statement Schedules

Other than as discussed above, this Form 10-K/A does not reflect events occurring after the filing of the Original Filing or modify or update disclosures (including the exhibits to the Original Filing) affected by subsequent events, except for the adoption of SFAS 123R (see Note 7 to the consolidated financial statements). Accordingly, this Form 10-K/A should be read in conjunction with our periodic filings made with the Securities and Exchange Commission subsequent to the date of the Original Filing, including any amendments to those filings. In addition, this Form 10-K/A includes updated certifications from our Chief Executive Officer and Chief Financial Officer as Exhibits 31.1, 31.2, and 32.1.

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## 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 of home appliances and consumer electronics. We sell major home appliances including refrigerators, freezers, washers, dryers and ranges, and a variety of consumer electronics including projection, plasma and LCD televisions, camcorders, DVD players and home theater products. We also sell home office equipment, lawn and garden equipment, mattresses and furniture and we continue to introduce additional product categories for the home and for consumer entertainment, such as MP3's, to help increase same store sales and to respond to our customers' product needs. We offer over 1,100 product items, or SKUs, at good-better-best price points representing such national brands as General Electric, Whirlpool, Frigidaire, Maytag, LG, Mitsubishi, Samsung, Sony, Toshiba, Serta, Hewlett Packard and Compaq. Based on revenue in 2004, we were the 12<sup>th</sup> largest retailer of home appliances in the United States. Additionally, historically we are the second or third leading retailer of home appliances in terms of market share in the majority of our established markets. Likewise, in the home entertainment product categories in which we compete, we rank third or fourth in market share in the majority of our established markets.

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 56 stores.

We have been known for providing excellent customer service for over 115 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 high level of customer service;
- highly trained and knowledgeable sales personnel;
- a broad range of competitively priced, customer-driven, brand name products;
- flexible financing alternatives through our proprietary credit programs;
- same day and next day delivery capabilities; and
- outstanding product repair service.

We believe that these strategies drive repeat purchases and enable us to generate substantial brand name recognition and customer loyalty. During fiscal 2006, approximately 62% 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 56 stores, an increase of over 115%, with several more stores currently under development;

- total revenues have grown by 199% at a compounded annual rate of 16.9% from \$234.5 million in fiscal 1999, to \$701.1 million in fiscal 2006;



- net income from continuing operations has grown by 367% at a compounded annual rate of 24.6% from \$8.8 million in fiscal 1999 to \$41.1 million in fiscal 2006; and
- our same store sales growth from fiscal 1999 through fiscal 2006 has averaged 9.2%; it was 16.9% for fiscal 2006. See additional discussion about same store sales under Managements Discussion and Analysis of Financial Condition and Results of Operations.

Our principal executives 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](http://www.conns.com). We do not intend for information contained on our website to be part of this Form 10-K.

### **Corporate Reorganization**

We were formed as a Delaware corporation in January 2003 with an initial capitalization of \$1,000 to become the holding company of Conn Appliances, Inc., a Texas corporation. Prior to the completion of our initial public offering (the "IPO") in November 2003, we had no operations. As a result of the IPO, Conn Appliances, Inc. became our wholly-owned subsidiary and the common and preferred stockholders of Conn Appliances, Inc. exchanged their common and preferred stock on a one-for-one basis for the common and preferred stock of Conn's, Inc. Immediately after the IPO, all preferred stock and accumulated dividends were redeemed, either through the payment of cash or through the conversion of preferred stock to common stock.

### **Industry Overview**

The home appliance and consumer electronics industry includes major home appliances, small appliances, home office equipment and software, projection, plasma and LCD televisions, and audio, video and portable electronics. Sellers of home appliances and consumer electronics include large appliance and electronics superstores, national chains, small regional chains, single-store operators, appliance and consumer electronics departments of selected department and discount stores and home improvement centers.

Based on data published in *Twice, This Week in Consumer Electronics*, a weekly magazine dedicated to the home appliances and consumer electronics industry in the United States, the top 100 major appliance retailers reported sales of approximately \$22.1 billion in 2004, up approximately 10.0% from reported sales in 2003 of approximately \$20.1 billion. The retail appliance market is large and concentrated among a few major dealers. Sears has been the leader in the retail appliance market, with a market share of the top 100 retailers of approximately 39% in 2004, down from approximately 42% in 2003. Lowe's and Home Depot held the second and third place positions, respectively, in national market share in 2004.

As measured by *Twice*, the top 100 consumer electronics retailers in the United States reported equipment and software sales of \$96.7 billion in 2004, a 7.9% increase from the \$89.6 billion reported in 2003. According to the Consumer Electronics Association, or CEA, total industry manufacturer sales of consumer electronics products in the United States, including imports, are projected to exceed \$109 billion by 2007. The consumer electronics market is highly fragmented. We estimate, based on data provided in *Twice*, that the two largest consumer electronics superstore chains together accounted for less than 28% of the total electronics sales attributable to the 100 largest retailers in 2004. New entrants in both the home appliances and consumer electronics industries have been successful in gaining market share by offering similar product selections at lower prices.

In the home appliance market, many factors drive growth, including consumer confidence, household formations and new product introductions. Product design and innovation is rapidly becoming a key driver of growth in this market. Products either recently introduced or scheduled to be offered include high efficiency, front-loading laundry appliances, three door refrigerators, double ovens, free-standing ranges, cabinet style dishwashers, and dual fuel

cooking appliances.

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 portable and traditional DVD players, digital cameras and camcorders, digital stereo receivers, satellite technology, MP3 products and high definition flat panel and projection televisions. 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 as consumers replace their analog products with digital products. We believe the following product advancements will continue to fuel growth in the consumer electronics industry and that they offer us the potential for significant sales growth:

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- *Digital Television (DTV and High Definition TV).* The Federal Communications Commission has set a hard date of February 17, 2009 for all commercial television stations to transition from broadcasting analog signals to digital signals. The Yankee Group, a communications and networking research and consulting firm, estimates that by the year 2007, HDTV signals will be in nearly 41.6 million, or 40%, of homes in the United States. This represents a compounded annual growth rate of 17.1% from the estimated 18.9 million homes receiving digital cable at the end of 2002. To view a digital transmission, consumers will need either a digital television or a set-top box converter capable of converting the digital broadcast for viewing on an analog set. According to the CEA, DTV unit sales are expected to grow from 12.0 million units in 2005 to 15.8 million units in 2006, representing an annual growth rate of 32.5%. We believe the high clarity digital flat panel televisions in both liquid crystal display (LCD), and plasma formats has increased the quality and sophistication of these entertainment products and will be a key driver of digital television growth as more digital and high definition content is made available either through traditional distribution methods or through emerging content delivery systems. As prices continue to drop on such products, they become increasingly attractive to larger and more diverse group of consumers.
- *Digital Versatile Disc (DVD).* According to the CEA, the DVD player has become the fastest growing consumer electronics product in history. First introduced in March 1997, DVD players are currently in 80% of U.S. homes. We believe newer technology based on the DVD delivery system, such as high definition DVD, “blu-ray”, and portable players will continue to drive consumer interest in this entertainment category.
- *Portable electronics.* Compressed-music portables, represented most notably by the Apple “iPod”, enjoy significant growth, and accounted for 84.5% of total dollar sales in battery-operated music portables in 2005 according to the CEA as reported in TWICE magazine. Apple shipped more than 14 million units of the iPod in the quarter ended December 31, 2005 as compared to 4.6 million in the prior year period.

## Business Strategy

Our objective is to be the leading specialty retailer of home appliances and consumer electronics 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:

- ***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 91% 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 attempts to address all customer complaints within 48 hours of receipt.
- ***Developing and retaining highly trained and knowledgeable sales personnel.*** We require all sales personnel to specialize in home appliances, consumer electronics or “track” products. Some of our sales associates qualify in more than one specialty. Track products include small appliances, computers, camcorders, DVD players, cameras, MP3 players and telephones that are sold within the interior of a large colorful track that circles the interior

floor of our stores. This specialized approach allows the sales person to focus on specific product categories and become an expert in selling and using products in those categories. New sales personnel must complete an intensive two-week classroom training program conducted at our corporate office and an additional week of on-the-job training riding in a delivery and a service truck to observe how we serve our customers after the sale is made.

- ***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 approximately 50 manufacturers and distributors that enable us to offer over 1,100 SKUs to our customers. Our principal suppliers include General Electric, Whirlpool, Frigidaire, Maytag, LG, Mitsubishi, Samsung, Sony, Toshiba, Serta, Poulan, Weedeater, American Yard Products, Hewlett Packard and Compaq. To facilitate our responsiveness to customer demand, we use our prototype store, located near our corporate offices in Beaumont, Texas, to test the sales process of all new products and obtain customers' reactions to new display formats before introducing these products and display formats to our other stores.

- ***Offering flexible financing alternatives through our proprietary credit programs.*** In the last three years, we financed, on average, approximately 57% of our retail sales through our internal credit programs. We believe our credit programs expand our potential customer base, increase our sales revenue and enhance customer loyalty by providing our customers immediate access to financing alternatives that our competitors typically do not offer. Our credit department makes all credit decisions internally, entirely independent of our sales personnel. We provide special consideration to the customer's credit history with us. Before extending credit, we match our loss experience by product category with the customer's credit worthiness to determine down payment amounts and other credit terms. This facilitates product sales while keeping our credit risk within an acceptable range. Approximately 58% of 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. Through our predictive dialing program, we contact 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 credit decisions and collections process enabled us to achieve a 2.9% net loss ratio in fiscal 2004, a 2.4% net loss ratio in fiscal 2005 and a 2.5% net loss ratio in fiscal 2006 on the credit portfolio that we service for a Qualifying Special Purpose Entity or QSPE.
- ***Maintaining same day and next day distribution capabilities.*** We maintain four regional distribution centers and three other related facilities that 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 130 transfer and delivery vehicles that service all of our markets. Our distribution operations enable us to deliver products on the day of, or the day after, the sale to approximately 95% of our customers.
- ***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 as well as on-site service and repairs for products that cannot be repaired in the customer's home.

### **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, opening new stores and updating, expanding or relocating our existing stores.

- ***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 demand;
  - adding new merchandise to our existing product lines;
  - training our sales personnel to increase sales closing rates;

- updating our stores on a three-year rotating basis;
-