

### Disclosed SEC Investigation

## Is the Conn's SEC Probe Hurting Earnings? It May Be a Good Time to Ask.

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### Conn's - \$CONN

- On Watch of Companies with Disclosed SEC Probes
- Added to Disclosure Games® List

**Analyst Summary:** From carefully timed delays in initial disclosure of its SEC probe in 2014, to failure to provide meaningful updates today, we think Conn's is playing Disclosure Games with investors about its SEC probe.

This isn't merely another case of us pointing out weak or misleading disclosure practices at a public company. Since Nov-2014, the SEC has been investigating Conn's underwriting policies and bad debt provisions. Only a few weeks ago, challenges on the credit side of Conn's business were widely blamed as the cause of an earnings disappointment. We believe the Conn's SEC investigation is formal as well, through in one of its disclosure sleights-of-hand, the company never says that directly.

Credit losses, underwriting policies and bad debt provisions live in close proximity when it comes to financial statement impact. Further, management judges the SEC probe in this area to be sufficiently material an exposure to the entire company that it must still be disclosed. The best thing an investor could do right now is try to ascertain why that is. To our view, investors should now place the burden on Conn's management to prove SEC pressure is not impacting earnings today.

**Facts of Interest or Concern:** Conn's is known as a hybrid retailer/lender. Debt plays a vital role in their sales efforts, operations, and, ultimately, the company's capacity to deliver on earnings. In Dec-2014, Conn's first disclosed it was being investigated by the SEC for its underwriting policies and bad debt provisions since at least Nov-2014. That investigation remains on-going as of the 10-K filed on 29-Mar-2016. SEC responses to our FOIA requests have been consistent with company disclosures, with an on-going investigation confirmed by the SEC on 21-Apr-2015 and again on 21-Dec-2015.

The following are four key facts that characterize the disclosures of Conn's SEC investigation –

- Conn's waited until the day after an earnings release and conference call to first disclose its SEC probe in Dec-2014.
- There have been no meaningful updates since first disclosure.
- We believe the investigation is now formal but the company has not given prominence to the same.
- SEC investigative disclosures don't give enough detail for you to analyze the risk they entail.

We now present the facts surrounding each of these elements. We include excerpts from the relevant disclosures later in this report along with our interpretative analysis.

### Conn's waited until the day after an earnings release and conference call to first disclose its SEC probe –

On 09-Dec-2014, Conn's released earnings and had a conference call at 11 am CST, that same day. It even

filed an accompanying 8-K, again, on 09-Dec-2014. But investors did not first learn about an SEC probe until a 10-Q was filed the day after the earnings call, on 10-Dec-2014. In that filing, Conn's said, "The Company received a voluntary request for information dated November 25, 2014 from the Fort Worth Regional Office of the SEC. The information request generally relates to the Company's underwriting policies and bad debt provisions."

Even though the company knew about the SEC probe two weeks earlier, by waiting to disclose it until the day after an earnings release and related conference call, the SEC probe did not receive prominence, nor were analysts able to ask about it on the call itself.

#### **No meaningful updates since first disclosure –**

Despite an investigation ongoing since at least Nov-2014, at no time has Conn's management enhanced, updated, or deviated from the original language (essentially a 10-word phrase) it first used to describe the nature of its SEC investigation. From the first disclosure in Dec-2014, through the most recent 10-K filed 29-Mar-2016, the company parrots the exact same phrase, which says that the SEC investigation, "generally relates to our underwriting policies and bad debt provisions".

#### **The investigation appears to have become formal without the company giving prominence to the same –**

While Conn's management has opted to not provide substantive updates on the investigation, a close parsing of related disclosures does give us a clue that it is likely worse than the company gives prominence. For example, we believe that sometime in the period between when the 10-Q was filed on 02-Jun-2015, and 09-Sep-2015, the SEC investigation became formal. Yet, Conn's has never once used the word 'formal' to describe its SEC probe.

As we said above, in its filing of 10-Dec-2014, the company stated, in part, "The Company received a voluntary request for information dated November 25, 2014 from the Fort Worth Regional Office of the SEC".

That word 'voluntary' is how you know this started out as an informal inquiry. As you will see when we walk you through the disclosures below, the company was still using the word 'voluntary' up through the 10-Q filed on 02-Jun-2015. However, by the 10-Q filed 09-Sep-2015, that word was dropped, to instead be replaced with the generic term, 'investigation'.

Based on our experience and expert legal guidance we've received, the fact they dropped the word 'voluntary' from their disclosures tells you something about the probe changed; that is, it probably became a formal investigation. In formal SEC investigations, requests that previously asked for a voluntary production of information are replaced with subpoenas compelling it. Assuming we are correct the Conn's SEC probe is now formal, and we think we are, we still do not know exactly when this occurred, why, what information the subpoenas sought, and to whom they were sent.

#### **SEC investigative disclosures don't give enough detail for you to analyze the risk they entail –**

Even after all this time, the only thing substantive we are told about the Conn's SEC probe is that it, "generally relates to our underwriting policies and bad debt provisions." As we stated above, these same 10 words are used repeatedly by the company without update or elaboration.

An earnings disappointment a few weeks ago was widely blamed on higher-than-expected credit losses. As we said in the summary, credit losses, underwriting policies and bad debt provisions live in close proximity when it comes to financial statement impact. Despite the potential connection, the SEC-related disclosures offer nothing that would allow the investor to *specifically* understand how the SEC investigation relates to the company's underwriting policies and bad debt provisions. Again, all we are told is the SEC probe "generally" relates to this mission-critical area of this company.

**Opinion and Analysis:** Those with an interest in Conn's should definitely try to find out what changes, if any, have been triggered by SEC scrutiny. Even when the SEC closes its investigations without taking enforcement action, as happens in nearly all the cases we follow, there still can be consequences for investors later. Just as the instinct is to pull your foot off the gas when seeing a police car on the highway, SEC pressure can trigger similar reflexes inside public companies.

For example, SEC scrutiny of a public company can bring about internal changes in practices, accounting, internal controls, and/or even additional auditor scrutiny. Any of these could result in negative surprises to investors later. Companies once seen as high fliers can inexplicably start missing earnings, as transactions that might previously have been booked without question are now subjected

to new standards. Companies can also lose the ability to forecast as well as was perceived in the past.

Regarding underwriting policies and bad debt provisions, ask yourself this simple question: What's the likely income statement impact from especially generous – or conservative – underwriting policies or bad debt provisions? How does this impact the balance sheet and statement of cash flows? The SEC will have the same questions with an eye toward implications for accounting and internal controls problems.

### The notable Disclosure Games used by Conn's management –

1. **Conn's waited until the day after an earnings release and conference call to first disclose its SEC probe in Dec-2014.** Waiting until the day after an earnings release and conference call to first disclose an SEC investigation is a ploy that has the effect of keeping analysts from asking pesky questions about the SEC probe on an open conference call. We are of a view that such ploys are typically deliberate, evasive, and manipulative. They are also a marker of a management team that will take extraordinary measures to keep bad news from coming to the attention of investors.
2. **There have been no meaningful updates since first disclosure.** A review of the history shows Conn's has done little but issue what we call cut-and-paste updates on its SEC exposure. However, for the cut-and-paste variety of update to have credibility, you have to believe no phone calls or documents were exchanged, no meetings or other conversations took place, and no testimony was requested or given.  
  
We believe Conn's has a formal SEC investigation and it's been going on for a long time. It may even be impacting earnings. We don't buy for a second that there is nothing new to report.
3. **We believe the investigation is now formal but the company has not given prominence to the same.** Using some disclosure sleight-of-hand when a probe becomes formal is, unfortunately, a ploy we see too often. Whether given prominence or not, in the face of a formal SEC investigation, you really want to know to whom the subpoenas were sent, and what they sought.
4. **SEC investigative disclosures don't give enough**

**detail for you to analyze the risk they entail.** Even after all this time, the only thing substantive we are told about the Conn's SEC probe is that it, "generally relates to our underwriting policies and bad debt provisions."

What does that sentence really mean; that is, what does it *specifically* mean when a company says an SEC probe, "generally relates to [a company's] underwriting policies and bad debt provisions."? Can you model that into earnings? Can you confidently assess the best/worst case scenarios based on that disclosure? Of course you can't. That leaves you with an exposure management judged material that you cannot independently assess. Unless it's a special situation, we recommend avoiding any investment that cannot be reasonably analyzed.

**Notable Disclosures:** Below is a steady stream of disclosures made on what we believe is now a formal SEC investigation of Conn's which the company says started in Nov-2014. Aside from subtle changes in language that signal to us the investigation is likely now formal, the updates are of the useless cut-and-paste variety.

### **Most recent disclosure: From the 10-K filed 29-Mar-2016 –**

Regulatory Matters. We are continuing to cooperate with the SEC's investigation, which began on or around November 2014, which generally relates to our underwriting policies and bad debt provisions. The investigation is a non-public, fact-finding inquiry, and the SEC has stated that the investigation does not mean that any violations of law have occurred.

### **Update: From the 10-Q filed on 8-Dec-2015 –**

"We are continuing to cooperate with the SEC's investigation which generally relates to our underwriting policies and bad debt provisions. The investigation is a non-public, fact-finding inquiry, and the SEC has stated that the investigation does not mean that any violations of law have occurred."

### **Update: From the 10-Q filed 09-Sep-2015 –**

"Regulatory Matters. We are continuing to cooperate with the SEC's investigation which generally relates to our underwriting policies and bad debt provisions. The investigation is a non-

public, fact-finding inquiry, and the SEC has stated that the investigation does not mean that any violations of law have occurred.”

Below, you will see we repeatedly highlighted in bold text the expression, “a **voluntary request for information**” which the company used in three prior disclosures. That term is missing from the disclosures from Sep-2015 forward. If they could use that term they still would. They cannot, likely because subpoenas showed up as part of a formal probe. If true, they are no longer “voluntarily” providing information to the SEC. Instead, they are responding to subpoenas issued as part of a now-formal SEC investigation of Conn’s.

**Update: From the 10-Q filed on 2-Jun-2015 –**

“We are continuing to cooperate with **the SEC’s voluntary request for information** dated November 25, 2014, from the Fort Worth Regional Office of the SEC, which generally relates to our underwriting policies and bad debt provisions. The investigation is a non-public, fact-finding inquiry, and the request states that it should not be construed as an indication by the SEC or its staff that any violations of law have occurred. “

**Update: From the 10-K filed on 1-Apr-2015 –**

“We received a **voluntary request for information** dated November 25, 2014 from the Fort Worth Regional Office of the SEC. The information request generally relates to our underwriting policies and bad debt provisions. The request states that it is part of an informal, non-public, inquiry, which, as noted by the SEC, should not be construed as an indication by the SEC or its staff that any violations of law have

occurred. We have been and intend to continue to cooperate with the SEC’s inquiry. “

**Initial disclosure: From the 10-Q filed 10-Dec-2014 –**

“Regulatory Matters. The Company received a **voluntary request for information** dated November 25, 2014 from the Fort Worth Regional Office of the SEC. The information request generally relates to the Company’s underwriting policies and bad debt provisions. The request states that it is part of an informal, non-public, inquiry, which, as noted by the SEC, should not be construed as an indication by the SEC or its staff that any violations of law have occurred. The Company intends to cooperate with the SEC’s inquiry. “

Conn’s filed an 8-K one day earlier, on 09-Dec-2014, to announce quarterly earnings that same day. Again, they already knew about the SEC probe at the time of this particular quarter’s earnings release, but elected to keep it out of that day’s related filings and press releases.

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**Notable Freedom of Information Act History / Data from the Probes Reporter Database**

26-Apr-2013	FOIA Response	No SEC investigative records found.
5-Jun-2014	FOIA Response	No SEC investigative records found.
26-Mar-2015	FOIA Response	Possible SEC investigation; access to records blocked.
29-Mar-2015	<b>PR Research</b>	Disclosure of SEC investigative activity found.
21-Apr-2015	FOIA Response	On-going enforcement proceedings confirmed; access to records blocked.
7-Dec-2015	FOIA Response	Possible SEC investigation; access to records blocked.
13-Dec-2015	<b>PR Research</b>	Disclosure of SEC investigative activity found.
21-Dec-2015	FOIA Response	On-going enforcement proceedings confirmed; access to records blocked.
29-Mar-2016	<b>PR Research</b>	Disclosure of SEC investigative activity found.

## Documents Acquired Under the Freedom of Information Act:

None in our library at this time.

**Disclosed SEC Investigation – On Watch List:** This indicator is assigned when a public company disclosed an SEC investigation. Regardless of the matter at issue, management judged the matter sufficiently material to the entirety of the company that it had to be disclosed. It is for this reason we recommend, at minimum, that this needs to be monitored. While an SEC investigation may go nowhere, the potential harm from an undisclosed SEC probe can also be quite serious. This company will be tracked on our Watch List of companies with disclosed SEC probes until such time it is either resolved or new data from the SEC causes us to revise the indicator.

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***Notes:** The SEC did not disclose the details on investigations referenced herein. All we know is that they somehow pertain to the conduct, transactions, and/or disclosures of the companies referenced. The SEC reminds us that its assertion of the law enforcement exemption should not be construed as an indication by the Commission or its staff that any violations of law have occurred with respect to any person, entity, or security. New SEC investigative activity could theoretically begin or end after the date covered by this latest information which would not be reflected here.*

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