

How to Analyze Receivables & Inventory

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How to Perform Inventory and Receivables Analysis

I wanted to go through a quick exercise that I perform during a [stock analysis](#).

A recent stock that has come up in the [Graham stock screener](#) and [forum](#) is CONN. Conn's Inc is a specialty retailer of home appliances such as fridges, freezers, washers, dryers and consumer electronics such as TV's, cameras, computers etc. Think Best Buy.

The company just released their results for their 2009 [4th quarter results](#) and the stock took a 17% hit. The actual financial statements hasn't been released but I wanted to show how these things are foreseeable by analyzing the inventory and accounts receivables. This has also been discussed in the [balance sheet analysis](#).

Sales, Inventory and Receivables Analysis

Quarterly Inventory & Receivables Analysis							
	2009/10	2008/10	2007/10	2006/10	2005/10	2004/10	2003/10
Revenue	\$182.80	\$183.70	\$189.40	\$173.70	\$173.30	\$132.90	\$117.40
% change from last QTR	-0.49% ↓	-3.01% ↓	9.04% ↑	0.23% ↑	30.40% ↑	13.20% ↑	
accounts receivable	\$156.20	\$77.20	\$35.80	\$30.60	\$23.40	\$15.60	\$15.60
% change from last QTR	102.33% ↑	115.64% ↑	16.99% ↑	30.77% ↑	50.00% ↑	0.00% ↓	
inventories	\$71.70	\$106.30	\$97.50	\$77.20	\$71.60	\$60.90	\$54.40
% change from last period	-32.55% ↓	9.03% ↑	26.30% ↑	7.82% ↑	17.57% ↑	11.95% ↑	

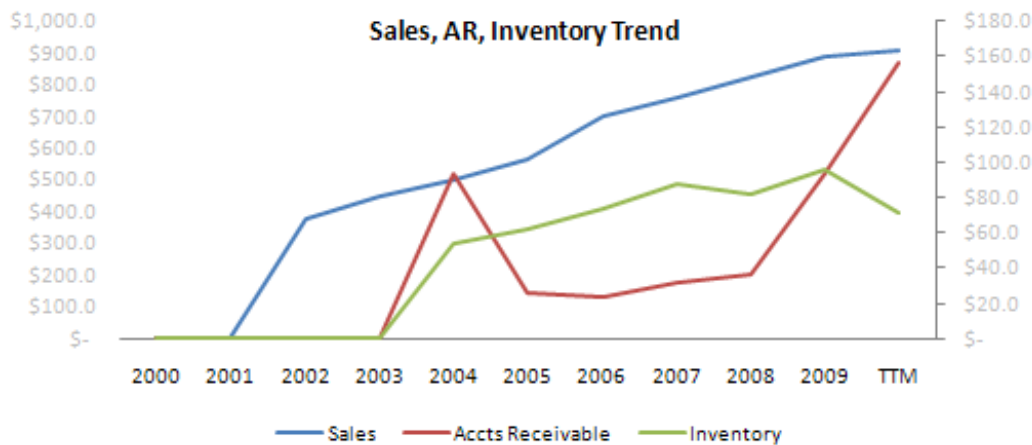
For any company that sells products, a careful look at the correlation between sales, accounts receivables and inventories is crucial. In the above example, I've only compared the 3rd quarter statements but you can see that CONN does not know how to manage their assets.

From what I see, the problem began to surface in 2006 where revenue only increased 0.23% while accounts receivables increased 31% and inventory went up 8%. Before 2006, the company was able to grow revenues at a faster rate than accounts receivables and inventory but from 2006 onwards, the correlation worsened until 2008 where you can immediately see that things were bound to fall apart.

In 2008, revenues declined 3% compared to the previous comparable period while **accounts receivables increased by 116%** and inventories up 9%.

The same thing happened in 2009 where accounts receivables increased another 102%! The only thing waiting for CONN is trouble, and it finally surfaced in their latest quarter. It goes to show that Wall Street does not perform the proper analysis required.

Here is a graphical view of the same thing.



Whenever you see either accounts receivables or inventory increase quicker than sales, watch out. But for inventory, you need to dig deeper.

When raw materials component of inventories is advancing much more rapidly than the work-in-progress and finished goods components, this means that the company is receiving many new orders and an inventory buildup is necessary. So the company will simultaneously ship products from its finished goods inventory while ordering raw materials in larger amounts.

But in the case of CONN, the company only sells the items so 100% of inventory is finished goods so any excessive increase is a big [red warning sign](#).

Dirt Cheap or Value Trap

All valuations point to a cheap company. Looks like the intrinsic value is roughly \$15-\$16.

If I had come across CONN when I first started investing, I'm pretty sure I would have bought it. At today's price of \$4.61 it is definitely cheap and tempting

but until there are signs that management is able to get a handle on inventory and accounts receivables, it is best to leave it alone.

Sure the stock can go up, but it doesn't hide the fact that the company is struggling. CONN has also increased their accounts payables and taken on huge amounts of long term debt.

If I was to buy the stock now, I would only be speculating and hoping that things improve.

CONN Stock Summary

Disclosure

None

Valuation

Current Price	\$	4.61
NCAV	\$	6.94
Total Net Reprod. Cost	\$	26.01
Earnings Power Value (EPV)	\$	18.32
Discounted Cash Flow (DCF)	\$	18.49
Ben Graham Formula	\$	13.07

Margin of Safety

