COMPANY REPORT

# Columbia Sportswear Co (NasdaqNM:COLM)

RATING 4

CONTACT
Enitan Adebonojo, CPA; CFA (301) 255-6617 enitan@cfraonline.com
Alisa Guyer Galperin (301) 255-6620 alisa@cfraonline.com

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# Extended Payment Terms Pull 2005 Revenues into Q404

## CFRA REPORTS

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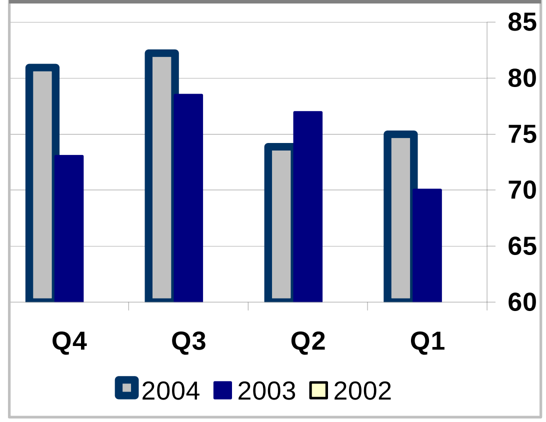
## UPCOMING EVENTS

## Key Takeaway

COLM is likely to post disappointing results in 2005 – as the Company struggles to replace 2005 sales revenues that were pulled into 2004. At the same time, margin pressure will likely be even worse than COLM projections as the Company moves excess inventory through the off-price channel.

Q4 Y/Y DSOs Spike at COLM




## Summary

COLM revenues benefited in Q4 from extended payment terms, which advanced sales revenue into the December quarter to the detriment of future performance. Evidence for this acceleration is a sharp spike in A/R, coupled with a single-customer receivable of 12.5% of total A/R. COLM also reports explicitly that the Company offers "extended payment terms for taking delivery before the peak shipping season" and a Company representative acknowledged that the large single-customer receivable involved "dating", or extended payment terms.

Additionally:

- Financially weaker customers represent an increasing portion of A/R, leaving COLM vulnerable to future bad debt adjustments.
- A decline in COLM's allowance account boosted Company earnings almost $0.06/share, year-over-year, during 4Q04.
- COLM has likely underestimated the extent to which excess inventory will pressure margins in the first half of 2005.

## Company Metrics

| | |
|---|---|
| Ticker | COLM |
| Exchange | NasdaqNM |
| Closing Price | $55.97 |
| P/E | 16.5 |
| F P/E (Cons.) | 13.6 |
| EV/EBITDA | 8.6 |
| P/S | 2.1 |
| Mkt. Cap | 2.3 Bil |
| Div. Yield | 0.0% |
| Short Interest | 1.8M |
| Short Ratio | 7.0 |
| Avg Shrs Traded | 209K |
| 52 Wk. Hi | $62.18 |
| 52 Wk. Low | $50.00 |
| Delete/Add | |
| Index Incl. | - |

## Score Card

| Concern Level | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| | Low or None | Mild | Moderate | Significant | Highest |

| | | |
|---|---|---|
| Overall Concern Level | 4 | Extended payment terms drive revenue growth while changes to the allowance for doubtful accounts improved Q4 operating results. Inventory concerns suggest that future margins may contract further than expected. |
| Operating Concern Level | 4 | Significant increase in accounts receivable suggests that revenues may have benefited from extended payment terms. A single-customer receivable of 12.5% of total A/R further heightens concerns. Year-over-year inventory growth also continued into the fourth quarter. |
| Quality of Cash Flows | 2 | While increases to A/R and Inventories did pressure cash flows at COLM, CFRA did not find evidence of cash flow manipulation or misrepresentation. |
| Quality of Earnings | 3 | Significant decline in the allowance for doubtful accounts contributes over 6% of net income, or nearly $0.06/diluted share in Q4. Without this boost, COLM would have reported only $0.91, missing consensus of $0.94. |
| Corporate Governance | 2 | CFRA notes a jump in insider sales during Q4 that preceded the early-January decline in stock price. Family holds three out of eight Board seats. |

CFRA's *Concern Level* represents our assessment of the quality and reliability of the Company's reported financial results as of the publish date. The *Concern Level* is reflective of our concerns related to the quality of earnings, quality of cash flows, operational health, and corporate governance practices of the Company. These concerns are presented in the Score Card included in our Company Reports, and support our overall *Concern Level*. CFRA's *Concern Level* does not represent a recommendation to buy, sell or hold a particular security.

## Q4 Revenue Boost from Early Shipment of Merchandise

*The acceleration of sales into the quarter could adversely impact revenues in the March 2005 quarter.*

CFRA is concerned that Q4 revenues likely benefited from the early shipment of merchandise to one of the Company's largest long-time customers. Early shipment allowed COLM to book Q4 (December) sales on merchandise that it normally sells during a later period. Furthermore, by providing extended payment terms, COLM ensures that the customer is indifferent to taking the merchandise early, as payment remains due at the same time as in previous years. This represents an unsustainable boost to revenues in Q404, and a commensurate drag on revenues in Q105. Evidence of these events can be found in the Company's December 2004 10K which notes,

- the Company had one customer who accounted for approximately 12.5% of accounts receivable outstanding at December 31, 2004.
- the increase in accounts receivable during Q4 resulted, in part, from increased sales in the latter part of the year; and
- the Company offers extended payment terms to customers "taking delivery before the peak shipping season"

A company representative also confirmed that extended payment terms were, in fact, made available to the single large customer accounting for 12.5% of all accounts receivable.

*As the customers previous A/R level could not have been more than 9.9% of total receivables, we estimate the possible boost to Q4 revenue to be at least $7 million.*

While we cannot calculate the customer's "normal" receivables level, we do know that it has not exceeded 10% (as this would have required disclosure). With total receivables of $267.7 million, a single-customer receivable of 9.9% would have been only $26.5 million, compared with the actual receivable of $33.5 million (see **Table 1**). This suggests that the boost to revenues was *at a minimum* $7.0 million.

At reported gross margins of 44.5%, this represents approximately $3.1 million in gross profit, $2.0 million in net income, and $0.05/diluted share.

In a conversation with CFRA, the Company declined to comment on the specifics of this receivable, indicating only that the customer was of very high credit quality. While we do not question the credit-worthiness of this particular customer, we do question the sustainability of the revenue growth it generated.

**Table 1: COLM's Increased Use of Extended Payment Terms Boosted Revenues by at Least $7 million.**

| | |
|---|---|
| Total Net Receivables at 12/31/04 | 267.7 |
| Single Customer Portion - 12.5% | 33.5 |
| 9.9% of Total Receivables | 26.5 |
| **Possible Boost to Q4 Revenue Growth** | **7.0** |

## Weaker Receivables Leave COLM Vulnerable to Future Bad Debt Reserve Adjustments

*With weaker receivables and lower estimated bad debt, COLM Is increasingly vulnerable to a future adjustment that would ultimately hit earnings.*

CFRA is concerned that COLM is also providing extended payment terms to some of its weakest customers, while the allowance for doubtful accounts (ADA) is declining.

Accounts receivable grew $61.6 million from $206.0 at December 2003 to $267.7 at December 2004. Measured in days sales outstanding (DSO), the increase was 8 days – from 73 days at December 2003 to 81 days at December 2004. This represents a Q4 record, the highest level Q4 DSOs have reached in the last five years.

A Company representative indicated that DSOs continue to rise as the Company provides "dating", i.e. extended payment terms, to its retail customers. These terms are made available to those customers willing to place their orders early, thereby providing COLM with critical visibility into its fall and spring backlogs.

CFRA notes, however, that extended payment terms are one of two incentives offered to retail customers. The Company also encourages early purchases through the use of incentive discounts. In fact, according to the Company's SEC filings, incentive discounts are the primary vehicle for encouraging pre-season orders. Extended payment terms, in contrast, are offered to customers *taking delivery* before the peak shipping season.

In either case, a COLM representative indicated that it is generally the customers with weaker balance sheets that choose dating over discounts; those with strong balance sheets generally prefer to just pay less for the product.

CFRA acknowledges that with extended payment terms made available to its customers, COLM will have fewer past due receivables suggesting a lower allowance for doubtful accounts. Nonetheless, with weaker receivables and lower estimated bad debt, we believe COLM is increasingly vulnerable to a future adjustment that would ultimately hit earnings.

## Q4 Earnings Boost From Reduction to ADA

*ADA/GAR declined from 4.1% at Q403 to just 2.8% at Q404.*

As weaker (i.e. higher risk) customers apparently represent an increasing portion of accounts receivable, CFRA would expect to see a commensurate increase in COLM's allowance for doubtful accounts. However, COLM's ADA has decreased as a percentage of gross accounts receivable. The allowance at December 2004 was $7.8 million representing 2.8% of GAR, while the allowance at December 2003 was $8.9 million representing fully 4.1% of GAR (see **Table 2**).

CFRA notes that an additional $3.5 million would have been required to retain the ADA account at Q403 levels. This represents $2.3 million in after-tax income or nearly $0.06/share.

**Table 2: ADA/GAR Decline Sharply during FY2004**

| | Q4 12/04 | Q4 12/03 | Q3 09/04 | Q3 09/03 | Q2 06/04 | Q2 06/03 | Q1 03/04 | Q1 03/03 |
|---|---|---|---|---|---|---|---|---|
| **GAR** | 275.5 | 214.9 | 384.3 | 331.5 | 144.9 | 137.4 | 179.3 | 139.4 |
| **ADA** | 7.8 | 8.9 | 9.6 | 10.4 | 6.4 | 9.1 | 9.4 | 9.2 |
| **ADA/GAR** | **2.8%** | 4.1% | **2.5%** | 3.1% | 4.4% | 6.6% | 5.2% | 6.6% |

## COLM Underestimates Future Margin Compression

*COLM has acknowledged that gross margins will contract, but company estimates may not fully reflect the trouble ahead.*

CFRA warns that COLM will experience margin pressure during upcoming quarters as the Company seeks to unload excess inventory through off-price channels. While COLM has acknowledged that gross margins will contract, we do not believe that Company estimates fully reflect the trouble ahead.

Inventories at COLM grew $38.6 million from $126.8 at December 2003 to $165.4 at December 2004. Measured in days sales, the increase is 6 days – from 84 days at December 2003 to 90 days at December 2004.

On the Company's January 27th conference call, COLM provided Q105 guidance – including year-over-year revenue growth of 15% and gross margin contraction of 170 basis points. This would place Q1 margins at 43.7% on estimated revenues of $237.7 million in Q105.

CFRA notes, however, that due to the seasonality of its business, COLM's margins generally contract *much further* sequentially between Q4 and Q1 (See **Table 3**).

With days sales in inventory up, we would expect Q1 margin contraction to be at least as high as during Q104, suggesting *maximum* gross margins of 43.1%, or 60 basis points lower than guidance.

For the following reasons, we believe that the decline will, in fact, be even higher:

- A Company representative indicated that in the prior year, between Q403 and Q104, sequential margin contraction was *lower than usual* as winter weather conditions extended well into January and February.

- While COLM generally takes about 5% speculative inventory into the fall season, the Company took 7-8% into the fall of 2004. $20 million of the excess inventory is related to this extra speculative inventory – which did not exist in the fall of 2003.

CFRA also notes that while COLM does not provide margin support to its retailers, it does – according to a Company representative – try to provide extra margin in the following year after a disappointment. While this is clearly preferable to straight margin support, it does represent a future cost to COLM.

The Company has noted that warm weather during Q4 squeezed margins at COLM. If – as is likely the case – retailers were also squeezed, COLM will continue to pay for this year's bad weather well into next year's season.

**Table 3: COLM Estimates Sequential Margin Contraction Below Historical Levels**

| | Q1 03/05* | Q4 12/04 | Q1 03/04 | Q4 12/03 | Q1 03/03 | Q4 12/02 | Q1 03/02 | Q4 12/01 | Q1 03/01 | Q4 12/00 |
|---|---|---|---|---|---|---|---|---|---|---|
| **GM** | 43.7% | 44.5% | 45.4% | 46.8% | 45.4% | 47.2% | 42.7% | 45.8% | 42.9% | 45.5% |
| **bps ∇** | 80 | | 140 | | 180 | | 310 | | 260 | |

*Company estimate

## Appendix One – Historical Financial Data ($s in thous.)

| INCOME STATEMENT | 12/31/04 | 09/30/04 | 06/30/04 | 03/31/04 | 12/31/03 | 09/30/03 | 06/30/03 | 03/31/03 | 12/31/02 | 09/30/02 |
|---|---|---|---|---|---|---|---|---|---|---|
| Net Sales | $301,776 | $415,759 | $171,102 | $206,670 | $257,429 | $373,409 | $152,077 | $168,871 | $217,321 | $331,504 |
| Cost of Sales | $167,344 | $219,371 | $97,871 | $112,787 | $137,024 | $194,592 | $87,358 | $92,127 | $114,816 | $170,717 |
| Selling/Gen./Admin. | $74,993 | $92,689 | $58,327 | $64,529 | $70,094 | $78,748 | $50,304 | $53,161 | $56,202 | $69,646 |
| Net Licensing Income | ($960) | ($1,594) | ($781) | ($697) | ($524) | ($678) | ($504) | ($105) | | |
| Net Income Before Taxes | $61,019 | $106,315 | $16,638 | $30,949 | $51,091 | $100,599 | $15,108 | $23,871 | $46,619 | $91,012 |
| Provision for Income Taxes | $21,662 | $37,742 | $5,906 | $10,987 | $18,904 | $37,027 | $5,665 | $8,952 | $17,482 | $34,130 |
| Net Income | $39,357 | $68,573 | $10,732 | $19,962 | $32,187 | $63,572 | $9,443 | $14,919 | $29,137 | $56,882 |
| **BALANCE SHEET** | **12/31/04** | **09/30/04** | **06/30/04** | **03/31/04** | **12/31/03** | **09/30/03** | **06/30/03** | **03/31/03** | **12/31/02** | **09/30/02** |
| ASSETS | | | | | | | | | | |
| Cash/Equivalents | $290,228 | $123,344 | $284,655 | $288,059 | $264,585 | $85,882 | $158,817 | $179,197 | $194,670 | $38,434 |
| Gross Acct. Receivable | $275,478 | $384,258 | $144,902 | $179,322 | $214,876 | $331,543 | $137,378 | $139,388 | $163,440 | $277,746 |
| Doubtful Accts. | ($7,825) | ($9,562) | ($6,385) | ($9,350) | ($8,852) | ($10,374) | ($9,134) | ($9,232) | ($9,341) | ($9,318) |
| Inventories | $165,426 | $194,381 | $209,388 | $128,077 | $126,808 | $166,072 | $181,646 | $115,759 | $94,862 | $133,645 |
| Deferred Taxes | $22,190 | $17,746 | $17,211 | $17,183 | $17,442 | $16,439 | $11,104 | $10,884 | $10,840 | $11,280 |
| Prepaid/Other | $10,536 | $10,363 | $7,669 | $6,889 | $5,371 | $6,459 | $9,195 | $4,456 | $6,006 | $5,124 |
| Total Current Assets | $756,033 | $720,530 | $657,440 | $610,180 | $620,230 | $596,021 | $489,006 | $440,452 | $460,477 | $456,911 |
| Prop./Equipment, Net | $155,013 | $150,089 | $141,947 | $131,238 | $126,247 | $119,024 | $121,125 | $122,557 | $124,515 | $124,070 |
| Total Assets | $949,444 | $908,837 | $837,282 | $779,074 | $783,766 | $752,272 | $647,321 | $599,378 | $592,817 | $588,582 |
| LIABILITIES | | | | | | | | | | |
| Accounts Payable | $78,309 | $71,291 | $88,545 | $40,082 | $62,432 | $51,452 | $61,395 | $37,781 | $49,370 | $47,174 |
| Accrued Expenses | $63,371 | $55,754 | $38,434 | $32,847 | $43,789 | $79,898 | $25,713 | $25,590 | $35,146 | $35,590 |
| Taxes Payable | | $34,762 | $2,599 | $10,475 | $8,069 | | | | | $30,666 |
| Curr. Port. LTD | $5,216 | $4,571 | $4,582 | $4,625 | $4,596 | $4,558 | $4,490 | $4,502 | $4,498 | $4,498 |
| Long Term Debt | $22,298 | $11,714 | $15,802 | $15,867 | $16,335 | $16,259 | $20,154 | $20,183 | $20,636 | $20,568 |
| Total Liabilities | $169,194 | $186,202 | $158,645 | $112,399 | $142,937 | $159,697 | $126,466 | $105,088 | $120,098 | $152,845 |
| SHAREHOLDERS' EQUITY | | | | | | | | | | |
| Total Equity | $780,250 | $722,635 | $678,637 | $666,675 | $640,829 | $592,575 | $520,855 | $494,290 | $472,719 | $435,737 |
| Total Liabilities & Shareholders' Equity | $949,444 | $908,837 | $837,282 | $779,074 | $783,766 | $752,272 | $647,321 | $599,378 | $592,817 | $588,582 |
| **CASH FLOWS** | **12/31/04** | **09/30/04** | **06/30/04** | **03/31/04** | **12/31/03** | **09/30/03** | **06/30/03** | **03/31/03** | **12/31/02** | **09/30/02** |
| Cash from Operating Activities | 167,985 | (115,150) | 10,099 | 30,764 | 182,124 | (59,238) | (23,379) | 21,592 | 160,031 | (18,440) |
| Cash from Investing Activities | (5,200) | (11,800) | (15,400) | (11,200) | (41,900) | (3,200) | (2,100) | (31,600) | (83,100) | (12,500) |
| Cash from Financing Activities | 600 | (36,100) | 2,700 | 3,500 | 5,800 | (9,800) | 4,200 | (5,500) | 100 | (1,900) |

## Appendix Two – Key Financial Ratios

| | 12/31/04 | 09/30/04 | 06/30/04 | 03/31/04 | 12/31/03 | 09/30/03 | 06/30/03 | 03/31/03 | 12/31/02 | 09/30/02 |
|---|---|---|---|---|---|---|---|---|---|---|
| ***DSOs*** | 81 | 82 | 74 | 75 | 73 | 78 | 77 | 70 | 65 | 74 |
| ***DSIs*** | 90 | 81 | 195 | 104 | 84 | 78 | 190 | 115 | 75 | 71 |
| ***CFFO - NI*** | 128,628 | (183,723) | (633) | 10,802 | 149,937 | (122,810) | (32,822) | 6,673 | 130,894 | (75,322) |
| ***Sales Growth (Y/Y)*** | 17.2% | 11.3% | 12.5% | 22.4% | 18.5% | 12.6% | 22.5% | 17.8% | 1.4% | 8.5% |
| ***ADA/GAR*** | 2.8% | 2.5% | 4.4% | 5.2% | 4.1% | 3.1% | 6.6% | 6.6% | 5.7% | 3.4% |