

THE EYESHADE REPORT

June 5, 2002

<u>Company:</u> CONCORD EFS, INC.	<u>Address and Phone:</u> 2525 Horizon Lake Dr., Suite 120 Memphis, TN 38133 (901) 371-8000
Ticker: CEFT	Shares Out (basic): 510.5 M
Exchange: NMS	Float: 439.1 M
Market Cap: \$ 15.4 B	Short Interest: 9.6 M
P/S: 8.6	Closing Price: (6/5/02): \$ 30.08
P/E: 50	52 Week Range: \$ 21.07 - \$ 35.06

Description of Business: Concord EFS, Inc. (the "Company" or "CEFT") has two business segments: Network Services, which provides automated teller machine (ATM) processing, debit card processing, deposit risk management, and coast-to-coast debit network access principally for financial institutions, and Payment Services, which provides payment processing for supermarkets, major retailers, petroleum dealers, convenience stores, restaurants, trucking companies, and independent retailers.

Summary

- Increase in accounts receivable days' sales outstanding.
- Cash flow from operations declined and turned negative despite an increase in net income.
- Decline in revenue growth rate.
- Insider selling.

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Financial Statement Review

Increase in accounts receivable days' sales outstanding (y/y) – For the quarter ended March 31, 2002 (Q1 02), accounts receivable (“A/R”) increased 64% from the year ago quarter, while revenue increased 23%. Sequentially, A/R increased 191%, while revenue declined 2%.

(\$ - 000's)	Q4 01	Q1 02	% change	Q1 01	Q1 02	% change
A/R	134,496	391,541	191%	238,248	391,541	64%
Revenue	473,604	462,143	(2%)	375,638	462,143	23%

For the quarter ending March 31, 2002 (Q1 02), quarterly days' sales in accounts receivable (“DSO” – defined as accounts receivable divided by quarterly revenue/days in the quarter)¹ increased to 76 days from 57 in the year ago quarter, and from 26 in the prior quarter.

	Q4 00	Q1 01	Q2 01	Q3 01	Q4 01	Q1 02
Qtr. DSO	65	57.1	56.2	71.3	25.6	76.3

The Company made two (2) acquisitions in Q1 02 accounted for as purchase acquisitions.² Acquisitions can distort comparisons between balance sheet and income statement items because of the requirement to immediately include all balance sheet items from the target on the acquirer's balance sheet,³ while income is only included from the date of purchase. However, the acquisitions were relatively small⁴ and, thus, it appears unlikely that they could have accounted for such a large increase in accounts receivable.

The Company issued a press release and held a conference call with analysts on April 30, 2002 to discuss Q1 02 results. However, the press release did not contain a balance sheet and no mention was made of the accounts receivable in the press release. We were unable to locate an archived copy of the conference call. The only comment we found from the Company that might be related to the increase in accounts receivable was in its 10-Q wherein it stated while discussing liquidity: “In the first quarter 2002 we used

¹ . All calculations in the table assume 90 days in each quarter.

² . On March 1, 2002, Concord acquired The Logix Companies, LLC, an electronic transaction processor. The acquisition, for which Concord issued approximately 0.9 million shares of its common stock and \$6.3 million in cash, was accounted for as a purchase transaction and is immaterial to Concord's financial statements. The allocation of the purchase price is preliminary because a valuation study has not yet been completed.

On January 1, 2002, Concord acquired H & F Services, Inc., an independent sales organization, for \$8.9 million in cash. Prior to the acquisition, Concord had purchased merchant contracts through H & F Services. The acquisition was accounted for as a purchase transaction and is immaterial to Concord's financial statements. CEFT, 10-Q (3/31/02), p. 5.

³ . Subject to acquisition-related adjustments.

⁴ . Id.

\$181.2 million in operating activities due primarily to the timing of settlement operations.”⁵

While it is possible that timing is the explanation for the increase, we note that the dollar amount of the sequential increase in accounts receivable (“Seq. A/R” = \$257,045,000⁶) represented 56% of the Company’s entire revenue in Q1 02 (“Seq.AR/Rev.”). Never in the past eight years has the Company’s failed to collect such a large percentage of its first quarter revenue by the end of the first quarter. (N.B. – Dollar amounts and percentages in negative numbers in the following tables represent amounts collected in **excess** of revenue, as there was a sequential decline in A/R in those periods).

(\$ - in 000’s)	Q1 99	Q1 00	Q1 01	Q1 02
Revenue	170,234 ⁷	257,768 ⁸	375,638	462,143
Seq. A/R	18,073	(11,759)	(69,508)	257,045
Seq.AR/Rev.	11%	(5%)	(19%)	56%

(\$ - in 000’s)	Q1 95	Q1 96	Q1 97	Q1 98
Revenue	25,928	33,895	47,045	69,632 ⁹
Seq. A/R	(10,555)	7,324	4,261	12,598
Seq.AR/Rev.	(41%)	22%	9%	18%

The Company describes its accounts receivable as follows:

Accounts Receivable: The majority of Concord's accounts receivable is related to the gross settlement dollars due from associations, networks, and trucking company customers. Revenue from most Payment Services customers is collected daily from settlement funds due to Concord's merchants or through an automated debit to the customer's account in the next month. Transaction revenue from Network Services customers is recorded as a receivable at month end and collected through a debit to the customer's account during the next month. In addition, Concord records an account receivable when revenue is recognized from sales of point of sale (POS) equipment to Payment Services customers.¹⁰

From its description of A/R, it appears that in order to incur a \$257,045,000 increase in A/R in a quarter, the Company would have to have either sold an unusually large number of point of sale equipment to Payment Services customers in the quarter

⁵ . CEFT, 10-Q (3/31/02), p. 19.

⁶ . Calculated by subtracting the 12/31/02 A/R of \$134,496,000 from the 3/31/02 A/R of \$391,541,000.

⁷ . The Company subsequently restated this figure to \$178,046,000 with its Q1 00 10-Q to reflect a purchase accounted for as a pooling-of-interest.

⁸ . The Company subsequently restated this figure to \$302,917,000 with its Q1 01 10-Q to reflect a purchase accounted for as a pooling-of-interest.

⁹ . The Company subsequently restated this figure to \$134,666,000 with its Q1 99 10-Q to reflect a purchase accounted for as a pooling-of-interest.

¹⁰ . CEFT, 10-K (12/31/01), p. 28.

(which would imply that the other portions of its Payment Services revenue actually declined year-over-year)¹¹ or experienced an extremely large increase in the amount of its Network Services revenue it recorded as an A/R by quarter-end.¹²

However, it seems unlikely that there was a large increase in point of sale equipment in the quarter as such equipment constitutes the majority of the Company's inventory,¹³ inventory actually increased in Q1 02 to \$21,643,000 from \$20,971,000 as of December 31, 2001 and inventory is at a relatively low level compared to the increase in A/R.

Further, Network Services could not have accounted for the entire sequential increase in accounts receivable of \$257,045,000 because the A/R increase actually exceeded the entire Network Services revenue for the quarter of \$185,657,000 (and almost equaled the Payment Services revenue in the quarter).

Business Segment and Total Quarterly Revenue¹⁴

(\$ - in 000's)	Q1 01	Q1 02	\$ change
Network Services	147,778	185,657	37,879
Payment Services	227,860	276,486	48,626
Total Revenue	375,638	462,143	86,505

Accordingly, it appears to us that something very unusual occurred in Q1 02 regarding the Company's A/R compared to its history since 1995. However, we did not locate an explanation as to what it was.¹⁵

¹¹ . The Company stated that the 21% year-over-year increase in Payment Services revenue was due primarily to increased transaction volumes. CEFT, 10-Q (3/31/02), p. 18.

¹² . The Company stated that Network Services revenue in the first quarter 2002 increased 25.6% compared to 2001 as a result of the addition of new network and processing customers and increases in transaction volumes. The increased transaction volumes resulted primarily from increased use of our network debit cards for payment at the point of sale. CEFT, 10-Q (3/31/02), p. 18. However, we did not find any explanation regarding the large A/R increase.

¹³ . CEFT, 10-K (12/31/01), p. 28.

¹⁴ . CEFT, 10-Q (3/31/02), p. 11.

¹⁵ . The most recent information we located regarding the make-up of the accounts receivable account was from the Company's 2001 Annual Report (year end - December 31), wherein it listed the following (in 000's) (CEFT, 10-K, 12/31/01, p. 34):

	2001	2000
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VISA and MasterCard accounts receivable	\$ 2,279	\$ 179,103
Trucking companies accounts receivable	28,206	40,871
Network accounts receivable	52,282	42,939
Payment accounts receivable	37,385	31,733
Other accounts receivable	17,749	16,276
	-----	-----
	137,901	310,922
Allowance for doubtful accounts	(3,405)	(3,166)
	-----	-----
Accounts receivable, net	\$ 134,496	\$ 307,756
	=====	=====

Cash flow from operations declined and turned negative despite an increase in net income – For the quarter ended March 31, 2002, the Company reported net income (“NI”) of \$54,209,000 versus net income of a negative \$25,992,000 in the year ago quarter. Despite the improvement in net income, cash flow from operations (“CFFO”) went in the opposite direction, with \$181,189,000 used in operations in Q1 02, while \$69,213,000 was provided by operations in Q1 01.

(\$ - in 000's)	Q1 01	Q1 02
NI	(25,992)	54,209
CFFO	69,213	(181,189)
CFFO – NI	95,205	(235,398)

This is the first time in the last eight years the Company has experienced a negative CFFO in its first quarter. In fact, up until Q1 02, the Company had consistently reported CFFO that was higher than its net income in its first fiscal quarter since 1995.

(\$ - in 000's)	Q1 99	Q1 00	Q1 01	Q1 02
NI	(1,341)	41,512	(25,992)	54,209
CFFO	25,264	58,576	69,213	(181,189)
CFFO – NI	26,605	17,064	95,205	(235,398)

(\$ - in 000's)	Q1 95	Q1 96	Q1 97	Q1 98
NI	3,459	4,660	12,333	17,349
CFFO	4,750	9,185	31,017	19,521
CFFO - NI	1,291	4,525	18,684	2,172

As with accounts receivable, the only comment we found from the Company regarding its use of cash in operations in Q1 02 was in its 10-Q wherein it stated: “In the first quarter 2002 we used \$181.2 million in operating activities due primarily to the timing of settlement operations.”¹⁶

Undoubtedly, the large sequential rise in accounts receivable (\$257,045,000) contributed to the use of cash in operations. However, the Company presents a one-line result in its quarterly CFFO reports, saving a more complete, indirect-style statement of cash flows presentation for its annual report. Hence, we cannot trace all the reasons for its decline in CFFO.

Decline in revenue growth rate – For the quarter ended March 31, 2002 (Q1 02), the Company’s revenue grew 23% year-over-year. While an impressive growth rate, it represents its lowest percentage year-over-year increase in revenue in the last seven years.

¹⁶ . CEFT, 10-Q (3/31/02), p. 19.

(\$ - in 000's)	Q1 99	Q1 00	Q1 01	Q1 02
Revenue	178,046 ¹⁷	302,917 ¹⁸	375,638	462,143
y/y % change	32%	70%	24%	23%

(\$ - in 000's)	Q1 95	Q1 96	Q1 97	Q1 98
Revenue	25,928	33,895	47,045	134,666 ¹⁹
y/y % change		31%	39%	186%

Insider selling – In the last seven months, approximately 11 insiders have sold approximately 4.7 million shares, with the bulk of those transactions occurring in November and December of last year.²⁰

Among individuals holding a relatively large number of shares, the person selling the largest percentage of his holdings was Richard Congemi, a director, senior vice president and President of the Network Services division of CEFT. We note that Network Services in the division that may have accounted for part of the large increase in accounts receivable in Q1 02 as described in the first section of this report.

Name	Position	Shares sold ²¹	Month(s) sold	% of holdings
Richard Congemi	Sr. V.P., Pres. - Network Serv.	259,000	11/01, 2/02	56% ²²
E. Labry, III	Pres. & Dir.	1.5 million	11/01, 12/01	13.5% ²³
D. Palmer	Chairman & CEO	1.5 million	11/01, 12/01	12% ²⁴
R. Kiphart	Director	1.2 million	11/01, 12/01	12% ²⁵

¹⁷ . The revenue figure originally reported was \$170,234,000. The Company subsequently restated this figure to \$178,046,000 with its Q1 00 10-Q to account for a purchase.

¹⁸ . The revenue figure originally reported was \$257,768,000. The Company subsequently restated this figure to \$302,917,000 with its Q1 01 10-Q to account for a purchase.

¹⁹ . The revenue figure originally reported was \$69,632,000. The Company subsequently restated this figure to \$134,666,000 with its Q1 99 10-Q to account for a purchase.

²⁰ . Insider selling information is obtained from third party sources whose accuracy cannot be guaranteed. We urge interested persons to verify this information independently.

²¹ . This is an approximate figure that includes shares held beneficially for others.

²² . This assumes total share ownership (including beneficial ownership) of 459,412 shares at the time of the first sale calculated by adding the sales (259,000) to ownership as of March 26, 2002 (200,412 per the 2002 Proxy Statement, p. 2) to ascertain a total ownership level.

²³ . This assumes total share ownership (including beneficial ownership) of 11,058,132 shares at the time of the first sale calculated by adding the sales (1,500,000) to ownership as of March 26, 2002 (9,558,132 per the 2002 Proxy Statement, p. 2) to ascertain a total ownership level.

²⁴ . This assumes total share ownership (including beneficial ownership) of 12,425,298 shares at the time of the first sale calculated by adding the sales (1,500,000) to ownership as of March 26, 2002 (10,925,298 per the 2002 Proxy Statement, p. 2) to ascertain a total ownership level.

²⁵ . This assumes total share ownership (including beneficial ownership) of 9,713,817 shares at the time of the first sale calculated by adding the sales (1,206,300) to ownership as of March 26, 2002 (8,507,517 per the 2002 Proxy Statement, p. 2) to ascertain a total ownership level.

1-Year Stock Chart



Chart courtesy of StockCharts.com (<http://stockcharts.com>).

12 Month Short Interest Data*

Settlement Date	Short Interest	Ave. Dly. Vol.	Days to Cover
May 15, 2002	9,576,804	4,861,841	1.97
Apr. 15, 2002	9,954,665	3,992,067	2.49
Mar. 15, 2002	14,499,134	5,055,804	2.87
Feb. 15, 2002	13,973,519	7,435,186	1.88
Jan. 15, 2002	14,986,381	4,297,275	3.49
Dec. 14, 2001	16,062,088	4,531,715	3.54
Nov. 15, 2001	15,549,542	4,869,906	3.19
Oct. 15, 2001	17,961,319	7,007,003	2.56
Sep. 14, 2001	15,089,424	10,610,756	1.42
Aug. 15, 2001	14,201,630	5,235,496	2.71
Jul. 13, 2001	16,342,404	9,021,754	1.81
Jun. 15, 2001	21,262,748	6,852,654	3.10

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