Rent-A-Center(Q3 2022 Earnings)

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Corporate Speakers:

- Brendan Metrano; Rent-A-Center, Inc.; VP, IR
- Mitchell Fadel; Rent-A-Center, Inc.; CEO & Director
- Fahmi Karam; Rent-A-Center, Inc.; Executive VP & CFO

Participants:

- Jason Haas; BofA Securities; Research Division, VP
- Kyle Joseph; Jefferies LLC; Research Division, Equity Analyst
- John Rowan; Janney Montgomery Scott LLC; Research Division, Director of Specialty Finance
- Anthony Chukumba; Loop Capital Markets LLC; Research Division, MD
- Robert Griffin; Raymond James & Associates, Inc.; Research Division, Director
- Carla Casella; JPMorgan Chase & Co; Research Division, MD & Senior Analyst
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PRESENTATION

Operator^ Good day, and thank you for standing by. Welcome to Rent-A-Center’s Third Quarter 2022 Earnings Conference Call. (Operator Instructions) Please be advised that today's conference call is being recorded. I would now turn the call over to your speaker for today.

Brendan Metrano^ Good morning, and thank you all for joining us to discuss Rent-A-Center's results for the third quarter of 2022. We issued our earnings release after the market closed yesterday. The release and all related materials, including a link to the live webcast are available on our website at investor.rentacenter.com.

On the call today from Rent-A-Center, we have Mitch Fadel, our CEO, and Fahmi Karam, our CFO. As a reminder, some of the statements provided on this call are forward-looking and are subject to factors that could cause actual results to differ materially from our expectations. These factors are described in our earnings release as well as in the company's SEC filings.

Rent-A-Center undertakes no obligation to publicly update or revise any forward-looking statements, except as required by law. This call also includes references to non-GAAP financial measures. Please refer to our third quarter earnings release, which can be found on our website for a description of the non-GAAP financial measures and reconciliations to the most comparable GAAP financial measures. With that, I'll turn the call over to Mitch.

Mitchell Fadel^ Thank you, Brendan, and good morning to everyone on the call today. This morning, we will start with a review of takeaways from the quarter and broader trends.

Then I will provide an update on operating initiatives, fourth quarter guidance in areas of focus heading into 2023. I'll then hand it off to our new Chief Financial Officer, Fahmi Karam, who officially joined the team a few days ago to share his thoughts on joining the company followed by a detailed review of the third quarter results and the fourth quarter outlook. And of course, then we'll take some questions.

As we stated in our earnings release after the close yesterday, third quarter revenue was slightly over $1 billion. Adjusted EBITDA was $115 million and adjusted EPS was $0.94. Those results are at or above the midpoint of the updated guidance ranges we provided in late September. The explanation we gave in September for lowering our original third quarter guidance was that weaker economic conditions had affected demand for durable goods and customer payment behavior.

Expanding on those comments for some additional perspective, the external environment has been an ongoing headwind for us since late last year after the stimulus program substantially wound down. This has been compounded by severe inflation this year, pressuring discretionary income and savings for many less affluent households who we primarily serve.

With respect to our business, this has caused a rise in delinquency and loss rate back to and temporarily above historical levels as well as the decline in merchant partner volumes that are lapping household durable goods demand pull forward from 2020 and 2021. On top of this, we think the number of non-traditional LCO consumers trading down has been limited thus far because overall employment remains strong, and there's been ample credit access broadly.

In summary, this is one of the more complex and challenging environments we've been through in a long time. While it's difficult to call timing, we believe conditions will normalize in our favor. At some point in the cycle, we should benefit from additional trade down to LPO as we have in the past -- capacity effects of stimulus program, see more normal inflation and more normal payment performance.

While we're not satisfied with recent financial results, the company continues to generate considerable adjusted earnings and free cash flow, demonstrating the strong underlying fundamentals of our business and enabling us to support shareholders through capital distributions.

Through the third quarter, we generated about $343 million of adjusted EBITDA, $2.83 of adjusted EPS, $363 million of free cash flow and paid $1.02 per share of dividends and repurchased $75 million worth of shares in the third quarter and October. While we continue to face external headwinds, we are committed to optimizing financial performance by focusing on controllable factors like underwriting, commercial execution and cost management. At the same time, we'll continue to position the company for a long-term successful investments in areas like technology, product and talent.

Shifting to third quarter results. Consolidated revenues, as I mentioned, $1 billion decreased 13% year-over-year with a Acima down 19% in the Rent-A-Center business segment down about 5%. The underlying factor behind the decrease was external conditions that led to fewer lease transactions to the Acima and lower overall open leases compared to the prior year period as well as higher delinquencies and losses.

These trends led to lower rental revenues and merchandise sales revenues. Adjusted EBITDA of $115 million decreased 34.6% year-over-year, primarily due to lower revenues and higher loss rates compared to the prior year period, partially offset by lower costs in the current year period.

So drilling down into our two key segments. Acima top line trends were generally in line with our original third quarter guidance assumptions with GMV down 23%, revenue down in the high teens. That decrease in GMV was comping over 19% growth in the prior year and was attributable to a combination of weaker household durable goods demand from our merchant partners and tighter underwriting compared to the prior year.

The underwriting changes we implemented in the first half of the year are achieving intended results with delinquency rates and loss rates down sequentially from the second quarter. With underwriting better aligned to the external environment, the team has been increasingly exploring and executing on opportunities to drive incremental GMV with favorable risk and margin profiles.

In addition, we're making good progress on the commercial side and recently launched initiatives that improved our market position compared to the prior year and helped us displace incumbents. We continue to invest in technology and enterprise sales capabilities to improve the experience for both consumers and enterprise-level accounts. The Rent-A-Center business segment continued to show resilient demand with deliveries slightly positive year-over-year.

However, this was more than offset by higher returns and charge-offs in the current year, likely stemming from inflationary pressure and discretionary income. The net result was a 1.7% year-over-year decrease in portfolio value at the end of the quarter. Revenues were $474 million with same-store sales down 5.3% in the current year. However, they're up 7% on a 2-year stack basis.

Collections continued to negatively impact rental revenues in the quarter illustrated by a step-up in our -- in the 30-day past due rate from approximately 2.4% in the second quarter to approximately 3.4% for the third quarter.

Those 30-day past dues, as you can see on Slide 5, have leveled off at approximately 3.7% for the past 3 months and should start to decline with additional underwriting changes and collections initiatives that have been implemented. Skip/stolen some losses as a percentage of revenue increased to 5.8% in the third quarter, up from 4.2% in the second quarter and 3.4% last year.

Our underwriting approach has been pretty consistent and have been pretty consistent over the past year, which leads us to believe the sequential uptick in loss rates is likely a result of persistent high inflation, depleting some customers' ability to cover expenses. We started tightening underwriting in the reticence segment when we saw this delinquency rise in the summer and to reduce the risk of losses going any higher, we're continuing to adjust our underwriting, and we will continue to refine it.

Although we project losses we'll remain in the high 5% range for the fourth quarter, with the leveling off of the 30-day past due ratio I previously mentioned and the additional measures were taken. We should start to show signs of improvement as we move into fiscal 2023.

Looking out over the next few quarters, other top priorities for the Rent-A-center business includes further developing our extended aisle services, improving our customer retention strategies to optimize returns, enhancing our digital customer experience through more personalized offers and testing smaller tech-enabled store footprints just to name a few.

For Acima, our top priorities are identifying opportunities to drive favorable risk-adjusted growth such as adjusting the value proposition to improve performance and pushing further into fast-growing channels and product categories. We'll also continue to advance our enterprise sales pipeline. Over the past few months, the Acima assigned new regional merchant partners and continues to have a strong pipeline of additional potential new retailers.

We remain confident in the company's long-term growth prospects and continue to invest in our ability to deliver significant profitable growth. When you put the pieces together, we expect our business will generate fourth quarter revenue of between $975 million and $1.025 billion, adjusted EBITDA of $95 million to $110 million and EPS of $0.65 to $0.85. Fahmi will provide additional guidance commentary here in a few minutes.

Looking at the big picture, the underlying fundamentals of the company remains solid with compelling top line growth opportunities, good profitability, strong free cash generation and a sound balance sheet. We believe we're on the right track to navigate this challenging environment. I'd like to thank the entire team for their continued dedication and strong efforts throughout the quarter.

As we announced in late September, the entire Rent-A-Center team and I are extremely excited to have recently brought in Fahmi Karam as the Chief Financial Officer, and

Fahmi joins Rent-A-Center with over 20 years of experience in both finance and accounting most recently as the Chief Financial Officer of Santander Consumer U.S.A.

We think Fahmi’s prior experience and -- experiences and deep understanding of both the non-prime consumer and data-driven lending will provide valuable insight and help drive growth opportunities for Rent-A-Center moving forward. And with that, I'll turn it over to Fahmi.

Fahmi Karam^ Thank you, Mitch, and good morning, everyone. I'll start today with a brief overview of my background and what attracted me to the opportunity of joining Rent-A-Center. Then I'll review third quarter financial performance and fourth quarter guidance. After which, we will take your questions.

For the past 7 years, I've worked at Santander Consumer U.S.A., a wholly owned subsidiary, Banco Santander in several different roles. Most recently and for the past 3 years, I served as the CFO. Santander Consumer U.S.A. was a publicly traded company until January of this year when Santander there acquired the remaining outstanding minority shares.

I joined Santander consumer from JPMorgan where I spent over a decade in investment banking. And before that, I started my career at Deloitte on the audit side. The decision to join Rent-A-Center was really based on my desires to contribute to the building and evolution of what I believe can be an even stronger company, one that can make a difference in the lives of our customers and create tremendous value for our shareholders.

I believe that addressing the needs of financially underserved consumers is a great mission and a highly compelling market opportunity with millions of U.S. household in need of these types of alternative financial solutions.

Rent-A-Center's leading omnichannel lease-to-own business, coupled with a strong margin profile and a healthy balance sheet, the company is very well positioned to execute on its strategic objectives and grow the business profitably. I feel that my experience and skill set should enable me to have a significant impact on the company's success in capitalizing on these opportunities.

Moving on to the financial results. As Mitch discussed earlier, the external environment is the biggest factor that impacted third quarter results, pressuring demand for consumer durable goods and our customers' ability to make lease payments. Consolidated rental and fees revenues decreased 10.9% year-over-year, which was led by a 17.5% decrease for Acima compared to a 4.3% decrease in the Rent-A-Center business.

Merchandise sales revenue decreased 23.1%, mainly from a 24% decrease for Acima and a 20% decrease for the Rent-A-Center business. Consolidated adjusted EBITDA of $115 million was down 34.6% year-over-year in the third quarter, with a 33% decrease for the Rent-A-Center business and a 26% decrease for Acima.

Looking at the P&L drivers. The primary contributors to the decrease in adjusted EBITDA were lower revenues and higher loss rates, partially offset by cost control measures. Adjusted EBITDA margin was 11.2% for the third quarter compared to 14.9% in the prior year period due to the same factors that drove changes in EBITDA.

Moving on to the segment results. Acima GMV decreased 23% year-over-year during the third quarter. This was mainly driven by a decrease in lease applications compared to the prior year period that resulted from lower durable goods demand at our merchant partners, which was primarily attributable to pressure on consumer discretionary income and cycling over the impact on demand from stimulus programs in 2021.

Underwriting changes made in the first half of 2022 also contributed to the decrease in lease applications. Acima segment revenues decreased 19.1% year-over-year with rental revenues down 17.5%. This was primarily due to lower GMV year-to-date through September and a higher provision on delinquencies compared to the prior year.

Merchandise sales revenue also decreased year-over-year, mainly from the decrease in GMV over the past 2 quarters as well as fewer customers electing to use early payoffs due to the previously discussed macroeconomic factors. Skip/stolen losses in the Acima segment increased approximately 30 basis points year-over-year to 9% but decreased 260 basis points sequentially from the second quarter of 2022, consistent with our forecast. This improvement illustrates the Acima's ability to adjust underwriting to effectively manage risk in a changing environment.

Adjusted EBITDA during the third quarter was $63.6 million with an adjusted EBITDA margin of 12.6%, which decreased 130 basis points year-over-year. The margin decrease is attributable to lower current year revenue, driven by the lower GMV over the past 2 quarters of 2022. Sequentially, EBITDA margin improved by 260 basis points due to the improvement in loss rates from the second quarter as our underwriting initiatives began to materialize.

Moving to the Rent-A-Center segment. Revenue decreased 5.4% in the third quarter compared to the prior year period, with same-store sales down 5.3%. The decrease in revenue was primarily due to the rental and fee revenues, which were down 4.3% as a result of lower percentage of lease payments collected. Merchandise sales were also lower compared to the prior year period, reflecting lower use of early payoffs by our customers, primarily due to the effects of the wind-down of stimulus programs in 2021.

Skip/stolen losses increased 240 basis points year-over-year to 5.8%, primarily driven by macroeconomic pressures on our core consumers. Adjusted EBITDA margin decreased 670 basis points year-over-year to 16.2%, primarily due to lower revenue and higher loss rates, both driven by the worsening macroeconomic environment since the prior year period.

Below the line, net interest expense was $22.7 million compared to $19.7 million in the prior year. The effective tax rate on a non-GAAP basis was 26% compared to 24% in the prior year. The non-GAAP diluted average share count was $59.6 million in the quarter compared to $68.2 million in the prior year period.

GAAP diluted loss per share was $0.10 in the third quarter compared to a diluted earnings per share of $0.31 in the prior year period. After adjusting for special items that we believe do not reflect the underlying performance of our business, non-GAAP diluted EPS was $0.94 in the third quarter of 2022 compared to $1.52 in the prior year period. Year-to-date, we have generated $412 million of cash flow from operations, $363 million of free cash flow.

And during the third quarter, we paid a quarterly dividend of $0.34 per share. And from the third quarter through October of 2022, we repurchased 3.5 million shares at approximately $2.21 per share. Taking into account the shares purchased through October, the company has approximately $285 million remaining on its current share repurchase authorization. In addition, at quarter end, we had a cash balance of $166 million, gross debt of $1.4 billion, net leverage of 2.6x and available liquidity of $540 million.

Shifting to the financial outlook. I will add some additional details of the fourth quarter financial guidance that Mitch addressed. Note that references the growth or decreases generally refer to year-over-year changes unless otherwise stated. For Acima, we expect fourth quarter GMV will be down in the mid-20% range year-over-year as economic conditions continue to pressure demand for durable goods at merchant partners.

In addition, underwriting standards are tighter in the current year following the changes we made in the first half of the year. Revenue should be down low to mid-20% range, reflecting a lower lease portfolio value heading into the fourth quarter and lower current year GMV. We expect adjusted EBITDA margin will be in the low double-digit range with a loss rate of around 9%.

For the Rent-A-Center business segment, we expect portfolio value will finish in the fourth quarter down low to single mid -- single digits compared to the prior year with modest growth in deliveries, offset by higher returns, reflecting the pressure on customers' discretionary income. Revenue in same-store sales should be down mid- to high single digits, primarily due to lower rental and fees revenue resulting from a smaller portfolio and lower collection rates. Adjusted EBITDA margin is expected to be between 16% and 17%, with the loss rate to remain in the high 5% range, while underwriting and collection initiatives take full effect on the portfolio.

The Mexico and franchising segment should generate fourth quarter EBITDA similar to the third quarter. Corporate costs are expected to be up low to mid-single digits year-over-year. Below the line, fourth quarter interest expense should increase $3 million to $4 million sequentially from third quarter.

Depreciation and amortization and the effective tax rate should be similar to the third quarter. Regarding capital allocation, the top prior orders continue to be dividend payments, debt reduction and opportunistically repurchase shares similar to what we did in the past few months. Thank you for your time this morning. We will now turn the call over for your questions.

QUESTIONS AND ANSWERS

Operator^ Thank you. (Operator Instructions) The first question will be coming from Jason Haas of Bank of America.

Jason Haas^ Maybe to start with somewhat of a high level one. Over the past several quarters, we have seen the Acima skip/stolens get out above your range, and it seems like those are coming back down now, which is good. But at the same time, we're also seeing the Rent-A-Center business, it looks like those are starting to peak up above your range. So I'm curious just to hear your thoughts on like what's driving that from a high-level perspective? What's driving the difference in performance treating those businesses?

Mitchell Fadel^ Sure, Jason. This is Mitch. See when you look at the slides we provided with the new metrics like on Page 5, the Rent-A-Center pass-through rates, you can see that, that jumped in July and August, the 30-day rates. So it's more delayed in Acima from an impact standpoint other than before that, it was pretty normal before July and then certainly August. It's a different business.

So it's not surprising that it would be delayed little bit different customer and so forth, certainly more need-based customer and those types of things -- and the collections is a lot different in Rent-A-Center with the 2,000 stores and local collections and all that versus call centers.

So we weren't seeing it until late summer when the inflation really, really got away from us, I guess, you'd say. The good news is, as you can see on that slide, been level for 3 months now we started tightening in August. We're doing more now. So we would see that coming back down as we get into next year. It's not going to affect Q4 a lot as far as the similar numbers being in the high 5s.

But when you get into next year, you can see that level only in the last 3 months is going to pay dividends, and it's going to come down from there now that it's level off. So it's not still going up.

We're making changes to get it back down to more normalized levels and feel good about the changes we're making. Yes, you're right. We fixed Acima when that got out of line. As you can see on that slide, I think that might be Slide 4. But I say fixed, obviously, in this environment, you're tweaking almost every day and looking at different accounts and e-com versus in-store and all that every day. But we'll do the same thing with Rent-A-Center and get back in line. The good news is to spend level now for about 3 months.

Jason Haas^ That's great. And then maybe to focus in on the Rent-A-Center business, if I caught it right, I think you said you're expecting EBITDA margin. I think that was for the full year of 16% to 17% now. So I was curious if that's a good run rate to use going forward? And just if there's any risk that could come in as the portfolio, I guess, is starting to shrink now?

Mitchell Fadel^ Jason, just a clarification, the 16% to 17% was for the fourth quarter. Yes, it would be higher for the year. But that certainly would be the run rate in the fourth quarter, the 16% to 17%, of course, that's what the high -- that's high 5s loss rate, right?

So when you look at a run rate in the fourth quarter and then if that's 1.5% to 2% higher than the high-end of our range, that gives us -- if you said, well, can you do 16% to 17% next year, I'd say, well, we got like 2% help going into next year when you think about maybe 1.5 is better because it will take a few quarters to normalize at the beginning of the year. But yes there's some tailwind there when you look at it as a run rate.

Jason Haas^ That’s great.

Mitchell Fadel^ Thanks Jason.

Operator^ Thank you. One more while we prepare for our next question. Our next question will be coming from Kyle Joseph of Jefferies.

Kyle Joseph^ I'll start on Acima just hoping to get a sense for the GMV contraction. How much of that is underwriting versus just the macro pressures and trying to get a sense for the growth rate as we lap the underwriting changes you made at the start of the year.

Mitchell Fadel^ Yes. I think the -- it's hard to tell the exact number between underwriting and retail traffic. But it's more retail traffic in Acima than it is the underwriting, honestly. The -- especially in the furniture segment, which is more than 2/3 of our business or at least 2/3 of our business there. It's just been way down the applications from -- and the traffic in retail furniture.

So I think it's more of that than the underwriting. We still believe, long term, it's 10%, a double digit, I should say, double-digit growth business, not predicting that for 2023. But I think longer term, it's a double-digit growth model. Obviously, enterprise accounts have a lot to do with that as we had those. Yes, next year, you wouldn't expect more of the minus 20 when you start comping over minus 20, right? So I can't tell you.

I don't want to get too much into next year yet, but I can't tell you that it's going to be that double-digit growth next year just because we're lapping minus 20. It just depends what happens in the macro, which obviously signs aren't all that great of any change anytime soon.

So more of the retail traffic, I know we'll get asked if not by you, Kyle, in a couple of minutes about trade down, not seeing a lot of trade down yet, seeing some a little bit. I think more is coming. I think everybody believes more is coming as credit tightens as all that credit availability that came out of the pandemic dries up and is drying up based on (inaudible) comments yesterday, I think lenders above us in near prime and prime will tighten -- tightening is coming.

It's just a matter of when it's been a little slower this time around as compared to other slow-downs just because of unemployment and things like that are still so good. Credit availability was at an all-time high coming out of the pandemic to pull forward all those kind of things. But I think the trade down is coming. We're not predicting anything for next year at this point. We will be confident over the minus 20 kind of numbers. But I think long term, the way to think about that business in the double-digit range.

Kyle Joseph^ Yes. very fair. And yes, a good transition to my next question. But yes, you mentioned lack of trade down, but you did highlight at least at RAC, you're seeing kind of improving delivery trends there.

So what's driving that? Is that -- are we lapping? Are we getting to the point where a customer -- all the merchandise that consumers acquired in 2020 and 2021 are -- we've gone through that product cycle? Is it kind of a more bargain savvy customer you're seeing, but what's driving the kind of demand improvement or delivery improvement you mentioned at RAC?

Mitchell Fadel^ Yes, good question. That's -- there was slight delivery improvement quarter-over-quarter. Portfolio is under pressure because people can't pay as well. So that there’s more returns and obviously, there's more charge-offs affecting our portfolio. But still we're -- from a demand standpoint, you think about the 7-year same-store 2-year same-store stack to 7%.

And I don't think we said in our prepared comments, but I'll say it now, our portfolio in Rent-A-Center is down. We talked about it being down year-over-year a little bit and down by the end of the year, we expect it to be low to mid-single digits against September 30 2019, the portfolio is up 20%. So a lot of the focus today is going to be loss rates we've never seen before, 5.8%.

And certainly, we're not happy with those, and we're going to -- we're doing something about that and we're a little happy. I'd say a little happy because we've lot of work to do, a little happy about that 30-day number on Slide 5 being consistent for 3 months. But we get -- we're not happy with that. But that's where a lot of our focus is too. But we can't forget at the same time a portfolio of 20% going back to Q3 of 2019.

The business is still very strong. Jason was asking is 16%, 17%, what do we think going forward? Even those before you add a more normalized loss rate and projected EBITDA rates anyhow. But more specifically to your question, I think the difference in Rent-A-Center versus like Acima is Rent-A-Center depends on their own traffic, whether it's in-store traffic or e-com traffic Acima depends on retail partner traffic. Retail partner traffic is a little more discretionary. Rent-A-Center traffic has always been, and Kyle I have done this a long time.

Rent-A-Center traffic has always been more need-based than what happens in a retail store, not that some of that's not need, but almost all of Rent-A-Center gets its need based. We see it much higher conversion rates than Acima things like that when customers come to Rent-A-Center there's a need, and we fill it. And I think that -- the needs come back first before the discretionary. I think that's one short answer to your question, need over discretionary first.

I think there wasn't as much pull forward in Rent-A-Center because customer couldn't afford as much. The Rent-A-Center customer couldn't afford as much as there wasn't much pull forward. And I say well, but look, your same-store sales there had -- back then, there had to be a lot of pull forward.

Remember, most of the same-store sales was driven by higher retention and people keeping it a lot longer and paying out rather than returning. So there wasn't a tremendous pull forward, nothing like in retail. So I think those are the -- sorry, I ramble a little bit there. I got other things go through my mind when he asked those questions, Kyle, but those are the -- maybe that last part is my short answer.

Mitchell Fadel^ Thanks Kyle.

Operator^ Thank you. (Operator Instructions) Our next question will be coming from John Rowan of Jefferies.

John Rowan^ So I want to go -- I want to talk a little bit about this notion of trade down. I'm going to put Fahmi on the spot a little bit here. I wanted you to discuss kind of what triggers it. We're seeing it pretty specifically, I believe, at least in subprime auto, right? ABS spreads are really getting wide for really kind of tertiary issuers.

And there's a big trade down into some of the lenders of last resort as things tighten up, specifically driven by the ABS market. So I'm wondering if you could talk about what triggers the trade down, who's above you? How do they fund or if it's something else? What gets that ball moving toward consumer migration into your typical cohort?

Fahmi Karam^ Yes. Hey John, good to speak with you again, and I appreciate the question. The short answer to your question is liquidity. When there's ample liquidity out in the market, you'll see a lot of lenders lean into providing credit. There's still ample liquidity out there, just more expensive than it was in years past.

And so you've seen some of the other lenders talk about it specifically of the auto lenders, credit is still strong. Liquidity is still there and they're still lending. So until you start seeing them pull back as credit deteriorates they're still going to be active. And so that's why when Mitch says, we still haven't seen the trade down happen yet to the degree you would expect and we've seen in prior cycles. We do expect it to happen at some point, but just hasn't come through the door here just yet.

So things like unemployment still remaining strong as unemployment starts to tick up as we expect over the next several quarters, you'll start seeing some more credit tightening above us. The spread in the ABS market does shrink some margins for some of the other players, but you don't see them pull back just yet because liquidity is there. Once the liquidity starts drying up, you'll start seeing some credit tightening. Unemployment will be impactful for that. And then you'll start seeing the trade down come our way.

John Rowan^ You think, Fahmi, that with the -- I mean in underwriting, when everybody even starts to tighten, right? They tightened from the bottom. You don't tighten at top, right? And as prime customers so you tightened at the bottom, which is good for us. So as soon as there's any significant tightening there or any even insignificant tightening, it could be significant to us, right?

That's why it usually happens a lot faster than this, but you don't have 3% unemployment numbers usually in a downturn like this either. But when that happens, it comes to us first, right, because they -- you don't tighten underwriting all through the bins you started at the (inaudible).

Fahmi Karam^ Yes. And I think for us, looking at other’s delinquency rates picking up, they've been normalizing, but they haven't hit pre-pandemic levels yet. It's another early indicator for us will be delinquencies on some of those other larger financial institutions.

Mitchell Fadel^ Especially the near primes and the -- which is even more important than the big ones, right? The secondaries are even the more important ones (inaudible).

John Rowan^ Yes. And I think your point is valid there that they tighten from the bottom. And coincidentally, what obviously, we're seeing when you look at the ABS markets, right, especially in auto, which seems to be moving a lot faster here probably because of collateral values is that lower tranches of these deals that are going out are -- the spreads are widening out a lot faster in those tranches.

So I'm just trying to read the tea leaves, if we're looking at other lenders that may be accessing certain forms of liquidity, if we see certain tranches of spreads blowing out a lot faster than others, how that flows through. So that was just the point of my question, and that's it for me. Thank you.

Fahmi Karam^ Thanks John.

Operator^ (Operator Instructions) Our next question is coming from Anthony Chukumba of Loop Capital Markets.

Anthony Chukumba^ So two questions. First question, Acima, I certainly understand the fact that there was this demand pull forward and so lease up [cases] are down, and obviously, you have tightened credit. But I was wondering if you can give us any visibility in terms of what's going on with your door count in Acima.

Mitchell Fadel^ Yes. Good question, Anthony. Relatively flat (inaudible) little bit of growth, but lot of new -- there's always ins and outs in that number, but a little bit of growth in the third quarter. So couple of real good regional accounts.

We don't usually go by name. So we got a couple of good regional accounts coming on board, some that are coming on board as we speak. But a little -- there's growth there. The minus 20% GMV kind of numbers are not because we're -- the merchant count down or anything like that. It's really just the traffic in the retail stores.

Anthony Chukumba^ Got it. That's helpful. And then my second question, and it sort of segues into what the discussion has been. But as you think about what has to happen, I guess, both parts of your business just kind of turn the tide here from this sort of very unusual time period that we're going through. Like what would help more? Would it help more if inflation abated or to help more if the sort of long-awaited credit trade down was to start to happen?

Mitchell Fadel^ Good question. I wanted to say yes, but I don't want to -- I don’t think both, right. It’s obviously the best. I would say the latter is better for us, honestly. I mean I'm not an economist and Fahmi cannot (inaudible). But I think the latter that the trade down at this point is maybe more important than even the other. Just because the subprime customer, our customer has been hit hard for the whole year. And my experience is they tend to adjust.

And you don't see that in our loss rate, but you can see it in the credit starting to level off. And some of that was us not tightening until recently when the numbers spiked in July and August. So our customers tend to adjust -- it's not like that business has fallen apart with the inflation like we talked about with a 2-year stack and the way the portfolio is. So I think because the subprime customers already got hit and tends to adjust that probably the latter is if I had to pick only one out of the two, what do you think?

Fahmi Karam^ Yes. And I think we have to think about it from where we are today, to your point. Our core customers are already kind of been hit hard by inflation. And hopefully, that's most of the way peaked not hopefully trending down next year. And so where the growth for us would come is from people coming down and trading down.

Mitchell Fadel^ More so than like -- more so than deflation coming down 1% a quarter.

Fahmi Karam^ So I agree. I think it probably is the latter, but both would be nice.

Mitchell Fadel^ Yes. Yes.

Anthony Chukumba^ That's very helpful. Good luck with the fourth quarter.

Mitchell Fadel^ Thanks, Anthony.

Operator^ Our next question is coming from Robert Griffin of Raymond James.

Robert Griffin^ I want to kind of maybe ask a little bit more of a high-level question, but as we think about the puts and takes going forward in the earnings power of this business model, it seems like there's some opportunities to get loss ratios back down into more normal ranges, which would be a positive for profit.

And then at the same time, the portfolio is going to enter 2023 at a much smaller level in each of your two main businesses. So just help us calibrate which one of those is a larger deal as we think about tuning up our models? And then as a second part of that question, if we look at the back half year of 2022 earnings of the business, is that a good baseline for today's economic environment of what this business can earn without any meaningful trade down? Or is there anything else there that we should think about?

Mitchell Fadel^ The -- did you say the guidance for the fourth quarter, was that the last part of your question?

Robert Griffin^ Yes. It was just saying, if we look at what this business is implied to earn in the second half year of 2022, is that a good baseline of like the earnings power of this business in today's economic environment without any meaningful trade down or without any change in the consumer was the second part of the question?

Mitchell Fadel^ Yes. Yes, I think that's a good question. We don't want to get too far ahead, but I'll just talk long term, we don't want to talk too much about 2023, but the run rate in the fourth quarter is certainly the place to start thinking about the long term without trade down, if you're not going to plan any trade down in.

The portfolio is what the portfolio is, it's down. There's a little bit of a tailwind to these numbers based on the loss rates, like you said, from an EBITDA standpoint. But on the same hand, we're forecasting a 20% negative comp in GMV and Acima side for the fourth quarter. So there is puts and takes there, like you said.

But I think the run rate for the fourth quarter is the place to start. Like I said, there's some tailwind in the losses. From an EPS standpoint, there's going to be some tailwind in going forward in lower share count. But yes, without factoring in trade down, there's nothing else that's going to say, "Oh, no, don't forget there's another that the fourth quarter has been impacted by extras. There really isn't anything like that. Bobby, so that would be the place to start thinking about the long term.

Fahmi Karam^ There's a lot of uncertainty in the market. So it's tough to get too far ahead of ourselves on 2023, but we do expect continued headwinds as we enter into next year. Mitch mentioned some of the GMV comps. Those should improve year-over-year trends next year as we get further and further away from the stimulus quarters in 2021, but revenue could be pressured as demand comes down, especially on the Acima side versus the Rent-A-center.

Mitchell Fadel^ And even family, if those comps are 0 because you're comping over the negative 20. That doesn't -- 0 isn't going to drive the run rate of EPS in the fourth quarter higher.

Fahmi Karam^ Right. And then so -- and then on the EBITDA side, depending on how inflation takes hold and how the recession takes hold, you could see some pressure on losses even though we expect the Rent-A-Center wants to improve from the third quarter results.

And then if you think about interest expense, a lot of our debt is variable cost. And so if we continue to see rate hikes there, you're going to see a bigger impact in 2023 than you did in 2022. So definitely some puts and takes in a mixed bag. But 2023 when you compare it to the last couple of years could see some pressure.

Mitchell Fadel^ Yes. It certainly wouldn't be the way the last couple of years (inaudible) more of the run rates [along the use].

Robert Griffin^ Okay. That was it for my questions. I appreciate that was exactly what I was looking for. Best of luck here in this tough environment.

Mitchell Fadel^ Thanks, Bobby.

Operator^ The next question is coming from Carla Casella of JPMorgan.

Carla Casella^ I just have quick question on the same-store sales decelerated from 2Q into 3Q. And we saw some of your peers not see that same deceleration. I'm wondering is it becoming more promotional out there or if you think you lost any share in the core business?

Fahmi Karam^ No, the -- I suppose, deceleration is one way to think about it, Carla. It’s (inaudible) purely numbers being higher than our competitors or another way to think about -- and when I say pure numbers, I'm talking about -- well, for the quarter, and then there's like a 10% difference in 2-year stack comp against the -- against our competition and even the quarter was better.

But if the decal -- I had looked at the deceleration, honestly, that if there was a difference between us and the competition of a deceleration standpoint I'd say our same-store sales when you think about the portfolio being down less than 2% and same-store sales being down 5.3%, a lot of that's the collection rate because the portfolio would say we should have been closer to minus 2% rather than minus 5%.

Now some of that was sales because of the merchandise sales because there's a payout in the prior year, but still maybe it should have been 3, minus 3 instead of minus 5%. So a lot of it's collections, the payments that drove some of those losses. So we got a lot of work to do get collections back in line, but no, I don't think we've lost any market share, though.

Carla Casella^ And then on the -- just your thoughts in terms of capital allocation and debt paydown versus share buybacks? Do you set a leverage target? Is there a certain level where you expand your share buybacks or versus focusing on paydown debt?

Fahmi Karam^ Yes. Look, our long-term average -- or our long-term target for our net debt ratio is about 1.5x. We did buy back some shares through the third quarter in the first month of the fourth quarter. We just thought where the shares were trading was a compelling value for us to go ahead and buyback shares.

So we'll take a balanced approach, obviously, keeping in mind the uncertainty in the market that we just mentioned especially around the share buybacks, but we'll take a balanced approach and we'll be opportunistic. But the priorities haven't changed from a capital allocation.

Mitchell Fadel^ So it's (inaudible) just longer term. Thank you.

Carla Casella^ So the $1.5 billion isn't that -- it's not that you (inaudible) on buybacks until you get to that level?

Fahmi Karam^ No, that's just a long-term target for us to be at around that 1.5x level. Thanks Carla.

Operator^ Thank you. (Operator Instructions) The next question will be coming from Brad Thomas of KeyBanc.

Bradley Thomas^ My question was around the outlook for margins in the Rent-A-Center business. It's obviously got a very long history of having very attractive margins through good times and bad times, but we're coming off of, obviously, record levels of profitability in the last couple of years.

Can you just talk about (inaudible) that question of what you think sort of normalized margins are for Rent-A-Center maybe how that's changed structurally? And then just what sort of levers you have on the fixed and variable cost side as we think about perhaps some challenges ahead with comps getting a little bit slower there.

Mitchell Fadel^ Sure, Brad. Good morning. Good question. I think we talked about the 16% to 17% range now, and that's with losses in the high 5s. So if you if you normalized you're at that 18% range, maybe a little [north] of 18%. Can we get the question like, can we get back to 20%? I don't know. Certainly, what happens with the -- from a portfolio standpoint, has a lot to do with that.

The other thing about the 18% is payments are -- if we get back to 18% with those lower loss rates, the normalized loss rates, the payments will be better. So the revenue collected number, the retention is better. So maybe you can get back there. But I think the run rate with a little tailwind for the loss number coming down is the right way to think about the long term of that business.

The labor costs over the last 18 months are -- have obviously gone up like that for everybody in the store. We've off -- been able to offset it with hours, lot more is coming from e-com, which helps us reduce our hours in stores, technology helps us reduce hours in the stores as far as how many customers you have to call versus texting and so forth. So there's some offsets there. But I think in the long -- in the short term, if you thought of the 16% to 17% and add a normalized loss rate, you'd be close to a long-term number.

What we can do in the long term, we are testing some smaller square footages to take some of that overhead out from a real estate standpoint as e-com grows in stores become half fulfillment centers for e-com and half handling the business that comes in the store.

So we're looking at the long term, what can we do from a real estate standpoint to reduce those costs on the real estate, not necessarily reduce locations, but reduce actual size of locations is a big one. We always are looking at our trucks and now we being efficient with how many trucks we have on the street and so forth and the labor, as I mentioned. Those are the big ones from a fixed cost standpoint. Thanks Brad.

Operator^ Thank you. Our final question will be coming from Vincent Caintic of Stephens.

Vincent Caintic^ Just one. I appreciate the commentary about the tough environment. I wanted to focus on your cash flow, though, even though the environment has been tough, your cash flows has remained resilient and encouraging to see the share repurchases and of course, your dividend is still strong.

So I'm wondering, as things are tough and maybe GMVs not growing as fast and not putting the free cash flow back towards issuing leases. How you're thinking about the resiliency and cash flow and if not for growth, what else could you do? And maybe the follow-up on the -- your appetite for share repurchases or other forms of investing that capital.

Mitchell Fadel^ Sure, Vincent, I'll start. Fahmi can jump in. The cash flow is strong with -- even stronger with minus 20% GMV in the large segment like Acima. The best is for us will be a little less cash flow next year and more -- buy more product, right, than the working capital side because that's a better long-term play.

But in the meantime, certainly the capital allocation hasn't changed what Fahmi talked about, we do have a long-term goal again down to 1.5x. We'll be opportunistic on share repurchases we were in the last 3 months. But going forward, it really has not changed from a capital allocation standpoint.

Fahmi Karam^ Yes. I mean I would just reiterate what we said earlier around the uncertainty left in the market. Obviously, we feel good about where we are today from a liquidity standpoint, having about $540 million of available liquidity to us. We've demonstrated that if we feel like the best use of that cash is buying back shares that we did that. We did a lot of that in the October time frame.

But we are mindful of the environment that we're heading into. So we'll take a balanced approach. The waterfall is invest in the business, paydown debt and opportunistically buyback shares and return capital to our shareholders. So we'll continue to be very thoughtful in our approach around capital allocation and utilize that free cash flow as best as we can.

Mitchell Fadel^ Thanks, Vincent.

Operator^ Thank you. That concludes the Q&A session. I would like to turn the call over to Mitch Fadel for closing remarks.

Mitchell Fadel^ Thank you. Thank you, operator. Thank you, everyone, for your time this morning. We appreciate it. We appreciate your support. We're working hard in a very uncertain environment, and we'll continue to do that.

We'll continue to focus on the things we can control, like our costs and our underwriting and our -- and capital allocation, we just -- Fahmi was just talking about, and we'll continue to focus on the company and building the team, like bringing people in like Fahmi to build the team to accomplish the great things that we know we can accomplish still believe we can accomplish.

Maybe it's a little bit of a delay with the uncertain environment, but we got a lot of things left to do and look forward to doing them and accomplish them over the next number of years for you. Thank you.

Operator^ This concludes today's conference call. Thank you all for joining. You all have a great day.