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Rent-A-Center, Inc. (RCII)

Q4 2019 Earnings Call

CORPORATE PARTICIPANTS

Daniel O'Rourke
Senior Vice President-Finance, Rent-A-Center, Inc.

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc.

Maureen B. Short
Executive Vice President & Chief Financial Officer, Rent-A-Center, Inc.

OTHER PARTICIPANTS

Bradley Thomas
Analyst, KeyBanc Capital Markets, Inc.

Kyle Joseph
Analyst, Jefferies LLC

John Allen Baugh
Analyst, Stifel, Nicolaus & Co., Inc.

Robert Griffin
Analyst, Raymond James & Associates, Inc.

John Rowan
Analyst, Janney Montgomery Scott LLC

Anthony Chukumba
Analyst, Loop Capital Markets LLC

Vincent Caintic
Analyst, Stephens Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good morning and thank you for holding. Welcome to Rent-A-Center's Fourth Quarter Earnings Conference Call. As a reminder, this conference is being recorded, Tuesday, February 25, 2020. Your speakers today are Mr. Mitch Fadel, Chief Executive Officer of Rent-A-Center; Maureen Short, Chief Financial Officer; and Daniel O'Rourke, Senior Vice President of Finance.

I would now like to turn the conference over to Mr. O'Rourke. Please go ahead, sir.

Daniel O'Rourke

Senior Vice President-Finance, Rent-A-Center, Inc.

Thank you, Lisa. Good morning, everyone, and thank you for joining us. Our earnings release was distributed after market close yesterday and an outline of our operational and financial results for the fourth quarter and full year 2019. All related materials including a link to the live webcast are available on our website at investor.rentacenter.com.

As a reminder, some of the statements provided on this call are forward-looking statements which are subject to many factors that could cause actual results to differ materially from our expectations. Rent-A-Center undertakes no obligation to publicly update or provide any forward-looking statements. These factors are described in our earnings release issued yesterday as well as in the company's SEC filings.

I'd now like to turn the call over to Mitch.

Mitchell E. Fadel

Chief Executive Officer & Director, Rent-A-Center, Inc.

Thank you Daniel, and good morning everyone. Thank you for joining us. We will be providing a voiceover to the presentation shown on the webcast and it can also be found on investor.rentacenter.com.

2019 marked a milestone year for Rent-A-Center and as you can see on slide 3, we significantly improved profitability and cash flow. Performance was driven by revenue growth and efficiency initiatives. We made strategic investments and are taking our retail partner segment to the next level, and we profitably grew the Rent-A-Center Business as well.

Comparable store sales were positive in all operating segments fueled by continued enhancements in our value proposition and in e-commerce. We strengthened our balance sheet through a significant reduction in debt and used excess cash to invest in our growth strategy while simultaneously initiating a 16% increase in our quarterly dividend.

We feel great about the business and believe we're well on the path of sustainable earnings growth. We have a business that generates significant cash and channels we intend to continue to evolve and optimize to capture growth. I'm extremely proud of our teams and confident in our strategy.

Now turning the fourth quarter on slide 4. While consolidated same store sales were up 1.6% over the fourth quarter last year, they've increased over 10% on a two-year basis. We ended the quarter with a record number of average customers per store. Operating earnings rose approximately 50% and the adjusted EBITDA margin improved 210 basis points versus the same quarter last year helped by favorable lease performance and efficiency initiatives.

Revenue growth in our retail partner channel accelerated in the quarter with invoice volume up 35% driven by organic expansion and strong performance in virtual. We believe we're well positioned to build on these trends in 2020 and our forecast for the year includes double-digit growth of our invoice volume and positive comparable store sales in our Rent-A-Center Business.

Now, Maureen will go over more specifics in a moment, so I want to focus for a few minutes – focus my comments on how we're thinking about the next several years including our earnings goals and strategic priorities.

As we outlined on slide 5, the lease-to-own market remains dynamic and resilient and e-commerce and virtual opened up sizable markets. We think the opportunity is north of $25 million with ample runway ahead.

As you saw in the earnings release, we renamed our segment reporting to align with our priorities around virtual and omni-channel. We launched an integrated retail partner solution under the Preferred Lease brand to start 2020. And Preferred Lease includes our virtual, our staffed and hybrid offerings and is the evolution of a decade of experience serving retail partners. It offers partners a flexible model serving bank and non-bank consumers for meaningful incremental revenue potential. The model has momentum with revenues in the quarter driven by organic expansion and virtual growth. The Rent-A-Center Business segment includes our stores and e-commerce platform and the segment is benefiting from our work to create a true omni-channel experience that serves customers where and how they want to shop.

E-commerce ended 2019 at 15% of revenues, up from approximately 10% last year. This channel leverages our stores to provide a highly effective distribution network that drives attractive unit economics with low acquisition costs and higher ticket. We think that's a unique advantage to drive synergies for both the Rent-A-Center Business and Preferred Lease.

So turning to slide 6, we believe our strategy to grow Preferred Lease in the Rent-A-Center Business can drive significant shareholder returns. We believe the combination can result in consistent mid-single digit revenue growth. This includes our goal for over $1.2 billion in revenue via Preferred Lease by 2022 and low-single digit same store sales via the Rent-A-Center Business. We think the combination can drive an 11% to 13% adjusted EBITDA margin over the long-term with profitability expected to benefit as Preferred Lease achieves scale.

So let's turn to the catalyst for our financial goal starting with Preferred Lease on slide 7. We currently operate in five out of the top six conventional furniture retailers. Invoice volume is growing in both staffed and virtual offerings and we're focused on increasing revenues with new and existing partners to achieve our three-year goal of over $1.2 billion in revenues and I should point out that $1.2 billion goal does not even assume a large national retail partner.

Turning to slide 8, the key driver and I'm not sure this is fully appreciated either is our differentiated model. Partners ask: how will this work for us? And our answer is the lease-to-own solution can be purely virtual, it can integrate with a credit application process or operate on a standalone basis. Preferred Lease can be a fully staffed option or can be staffed on weekends or during heavy traffic periods, whatever best addresses our partners desire for flexibility, control and consumer transparency. I think it's a very effective, highly effective model. We also serve banked and unbanked consumers with decades of experience in both and we're going to make sure we address the full spectrum of credit constrained consumers rather than just a subset of it. A powerful combination proven by the fact that our revenue per location is over seven times higher than competitors for retail partners given the benefits of the model I just described.

We have now leadership to drive growth. And we're making investments to improve the e-commerce experience for both traditional and pure play partners. These include a streamlined application process and integrated checkout on e-commerce – on e-commerce sites. To say the least, we're very excited about our pipeline and our prospects to grow Preferred Lease.

Turning to the Rent-A-Center Business on slide 9, we're extremely pleased with the performance in that segment as well. Solid growth in the portfolio in 2019 supports our plan to achieve low-single digit comparable sales growth in 2020 and we're building on our merchandising improvements we've made over the last two years. For example in 2019, we expanded assortments into jewelry, tools, handbags and tires and we're continuing to shift our mix to higher margin products and aspirational merchandise, that's offsetting performance of some consumer electronics categories.

Turning to slide 10, we're also achieving record levels of e-commerce traffic that's resulting in continued growth in comparable store sales. E-commerce sales are expanding our customer base with a new, younger demographic. These transactions are accretive relative to traditional in-store agreements. They have lower customer acquisition costs. Higher end products and stronger lease performance helps offset slightly higher skip/stolen loss rate on e-com.

We're rolling out additional site improvements in 2020 to improve the application process and reduce that risk. We're also excited about the new mobile-first platform for rentacenter.com which went live just last month. This platform has enhanced payment functionality, increases speed to market for site improvements and updates.

Our focus is to utilize technology to serve the lease-to-own customer across multiple channels. Our store base provides a highly effective network to address the final mile delivery and we're leveraging it for same-day delivery and for collections. I want to stress though while we're excited about the potential growth opportunities, we intend to achieve our objectives in a methodical disciplined way. We've done a tremendous amount of work to improve the organization and to support growth and we'll manage the businesses and our investments to ensure we're not sacrificing returns for revenues.

Now before I turn it over to Maureen, I want to mention, as you may have read in the press release, we entered into an agreement with the Federal Trade Commission subject to a 30-day comment period resolving the Civil Investigative Demand related to the purchase and sale of customer lease agreements in the Rent-A-Center Business that were received from the FTC in April of last year and there are no fines, no penalties, no admission of wrongdoing, fault or liability on the part of the company. The settlement permits us to continue purchasing and selling customer lease agreements. This inquiry is entirely unrelated to the large settlement with the FTC announced last week by Aaron's in regards to their Progressive segment. We have not received additional inquiries from the FTC and we have a long history of working with the FTC as well as other regulatory bodies to ensure customers clearly understand the key distinctions in our transaction that provide flexibility and added value and we will continue to do so.

We have no additional inquiries from the FTC at this time. I'll now turn it over to Maureen to discuss the financials and our 2020 guidance.

Maureen B. Short

Executive Vice President & Chief Financial Officer, Rent-A-Center, Inc.

Thanks, Mitch. Good morning, everyone. I'll cover financial highlights for the fourth quarter and review our guidance for 2020. Starting with slide 11, consolidated total revenues were approximately $668 million in the fourth quarter, an increase of 0.9% versus the same period last year. The gain was driven by a consolidated same store sales increase of 1.6% partially offset by refranchising and rationalizing our store base. Adjusted EBITDA was $63.7 million in the quarter and EBITDA margin was 9.5%, up 210 basis points over the same period last year. Non-GAAP diluted EPS was $0.58, up 66% over last year.

Turning to segment results which incorporate the changes noted in the release, Preferred Lease total revenues increased 10.8% in the fourth quarter versus the same quarter last year. The performance reflects the 35% increase in invoice volumes, driven by organic expansion and strong performance in the retail partner channel. Same store sales were up 2.1% in the staffed model versus the same quarter last year. We are encouraged by the results and optimistic about prospects to achieve invoice volume growth in each quarter of 2020. This will be the final quarter we will report same store sales for the Preferred Lease segment as we believe invoice volume is a more useful metric as we move forward with our hybrid model and newly launched virtual offering.

Adjusted EBITDA for Preferred Lease was $17.6 million or 9.2% of revenue. The year-over-year change in EBITDA as a percent of sales was driven by investments in people and cost to integrate technology to support future growth. The margin delta was also impacted by the mix shift to virtual locations which have higher skip/stolen losses than staffed locations. In total, skip/stolen losses were 14.2% of sales from the Preferred Lease segment in the fourth quarter. Lease performance was in line with our expectations for the quarter and we believe profitability can improve as we scale the virtual offering.

Turning to our Rent-A-Center Business which includes corporate-owned US stores and rentacenter.com, revenues were $438.8 million in the fourth quarter and benefited from a 1.2% increase in same store sales. Adjusted EBITDA for the Rent-A-Center Business was $72.1 million, up 520 basis points as a percentage of revenue versus the same quarter last year. The performance was driven the lower supply chain expenses and an increase in vendor marketing contributions as we continue to streamline the business. As a percent of revenues, skip/stolen losses were 4.1%, flat sequentially with the third quarter of 2019.

Finally in the Corporate segment, fourth quarter adjusted EBITDA increased $1.6 million and as a percentage of revenue increased 20 basis points versus the prior year driven by performance-based compensation.

Moving now to the balance sheet and cash flow highlights, cash generated from operating activities was $215 million for the year ended 12/31/2019. The company ended the fourth quarter with $70.5 million of cash and cash equivalent and outstanding indebtedness of $240 million, down $20 million from the end of the third quarter. In 2019, we paid down over $300 million in debt. The company's net debt to adjusted EBITDA ratio ended the fourth quarter at 0.7 times compared to 2.1 times at the end of the fourth quarter 2018.

Turning to our guidance for 2020 in our capital priorities of slide 12. On a consolidated basis, we're projecting revenues of $2.755 billion to $2.875 billion, adjusted EBITDA of $255 million to $285 million and non-GAAP diluted earnings per share in the range of $2.45 to $2.85. To summarize, the midpoint of the ranges equates to mid-single digit revenue and adjusted EBITDA growth, modest EBITDA margin expansions and double digit EPS growth. The guidance includes investments to support growth in both Preferred Lease and the Rent-A-Center Business. We're also providing revenue and EBITDA guidance for Preferred Lease and the Rent-A-Center Business.

For the full year 2020, we expect Preferred Lease revenues of $860 million to $910 million and adjusted EBITDA of $95 million to $105 million. We expect revenue growth across the Preferred Lease segment, with organic expansion in staffed model, the addition of virtual and hybrid doors, and growth in our retail partners' e-commerce channels.

Our 2020 estimate assumes roughly 20% organic invoice volume growth. We expect EBITDA growth and margin improvement for Preferred Lease to be influenced by mix shift and additional investments to support growth. We expect to maintain a low-double digit adjusted EBITDA margin for Preferred Lease. A higher mix of virtual will result in a lower gross profit offset by reduced operating expenses.

The mix change will also impact skip/stolen losses. We expect the metric to be 100 to 200 basis points higher in 2020 to an average of approximately 12% for the year in the Preferred Lease segment. For the Rent-A-Center Business, we're projecting 2020 revenues of $1.755 billion to $1.825 billion. As a reminder, the guidance does not include the impacts of any new franchising transactions. We're projecting adjusted EBITDA at $265 million to $285 million for the segment. Our revenue projection assumes low-single digit increase in same store sales for the year as we benefit from growth in the portfolio and e-commerce expansion offset by a lower store count. We expect EBITDA performance to benefit from an additional $10 million to $15 million in cost initiative which we believe should more than offset slightly higher skip/stolen losses from growth in e-commerce. We're projecting skip/stolen losses of approximately 4% for 2020 in the Rent-A-Center Business.

As you look to model the full year, there are a couple of additional items I'd like to point out. First, the share count, which ended the quarter at 56.6 million diluted shares [ph] up versus (00:16:11) last year due to higher employee stock compensation and shares issued in connection with the Merchants Preferred acquisition. As is our practice, our 2020 projection does not incorporate additional share repurchase activity and assume approximately $57 million diluted shares outstanding.

The second is the cadence of earnings. As compared to 2019, we expect to grow earnings in each quarter of 2020. Looking at the first half, we expect mid-single digit EPS growth in the first quarter as we invest in Preferred Lease and expect growth to accelerate in Q2 driven by cost savings initiatives. The second half should have a traditional seasonal pattern, with stronger growth in the fourth quarter versus the third quarter.

I'll close with a brief outline of our capital allocation framework on slide 13. As Mitch mentioned, we've made a great deal of progress to rejuvenate cash generation and profitability, and we're focused on growing the business in a disciplined way. Our priorities for cash are to invest in our business, followed by potentially taking advantage of M&A opportunities and returning cash to shareholders. 2019 reflected these priorities as we invested in the business, purchased Merchants Preferred, paid down debt, and increased our dividend which currently has a yield [ph] above (00:17:33) 4%.

We expect to generate free cash flow in the range of $105 million to $135 million in 2020, which is a decrease relative to 2019. As you recall, the settlement related to Vintage merger termination in 2019 resulted in a $65 million onetime benefit for free cash flow. Additionally, growth in EBITDA and lower interest costs will combine for a $30 million benefit year-over-year which we expect to be offset by higher cash taxes and investments to fund our growth initiatives.

We plan to increase capital expenditures to $40 million to $45 million for the year to invest in technology and analytics in order to grow digital channels in support of both the retail partner business and our e-commerce platform.

Free cash flow guidance also includes investment in working capital to fund invoice volumes. We believe these investments will generate a high rate of return and support profitability and cash flow. We also believe we can maintain our conservative balance sheet as we execute in our long-term financial and operational goals.

Our net debt to adjusted EBITDA was 0.7 times and we had total liquidity of over $235 million at the end of the year. As has been our practice historically, we intend to return excess cash to shareholder. We increased our quarterly dividend by 16% to start 2020, repurchased 59,000 shares in the fourth quarter. And we currently have share repurchase authorization of over $220 million.

We've returned nearly $800 million to shareholders in the form of share repurchases and dividend over the last 10 years, and we will continue to opportunistically allocate capitals to augment returns. As always, detailed income statements by segment are posted to our website and the 10-K will be filed by Friday, February 28.

Thank you for your time today. I'll now turn the call over for your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question today comes from the line of Brad Thomas from KeyBanc Capital. Your line is open.

Bradley Thomas
Analyst, KeyBanc Capital Markets, Inc.
Q

Hi. Good morning, Mitch and Maureen, and congratulations on a strong fourth quarter and strong year.

Maureen B. Short
Executive Vice President & Chief Financial Officer, Rent-A-Center, Inc.
A

Thanks, Brad.

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc.
A

Good morning, Brad. Thank you.

Bradley Thomas
Analyst, KeyBanc Capital Markets, Inc.
Q

Let's see. I wanted to just, first, start off with the new Preferred Lease business and the integration of Merchants Preferred. And I guess, just follow-up on where we are in that integration and where we stand today from a position of your ability to go out and market and pitch the new offering and potentially be landing some new more sizable accounts?

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc.
A

Good question, Brad. We're there. I mean, we're integrated. We're ready to go, we made some enhancements as Maureen mentioned to the technology – of course, that's an ongoing issue, right? We're always going to be enhancing especially in this day and age. So, it's always being enhanced but we're ready. We're out selling. We've added a number of people to the sales team, probably almost tripled the sales teams since we bought Merchants Preferred. We added a specific person for large national accounts, as you saw a press release may be about 10 days ago. So we've added to the sale teams, added to the technology. We're integrated and we've added a national accounts person solely to focus on the bigger accounts. So, we're up and running.

Bradley Thomas
Analyst, KeyBanc Capital Markets, Inc.
Q

Great. And on the Rent-A-Center side of the business, it would seem that the industry has faced some headwinds from things deflation and consumer electronics and potentially that shorter selling season over the holiday period. What did you all see in the fourth quarter and how are you feeling about the health of the portfolio? I mean, clearly, the guidance would imply that you feel good about momentum, but just curious if you've experienced any of those dynamics yourself.

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc.
A

We do feel good about it. We felt good about the fourth quarter. We had a really, really tough camp as you know, whatever the Rent-A-Center Business segment was 9% [ph] or something from (00:22:01) last year, we comped over that. So now we're in the – like the mid-10s on a two-year comp. So, we are very happy with the way it turned out. We have to adjust our plans. I mean you could see the one week less from a shopping period standpoint that was on the calendar for a long time. So, we knew it was there and we started our Black Friday sale a week earlier than we had the year before, things like that. So, you just have to adjust. And, we feel good about it.

As I mentioned that we've added a few new product lines. The deflation has been an issue. I'm not – I mean, I tell you, Brad, you know how long I've done this. I've done this for a number of years. So, we've been through quite a few cycles in the electronics category of having to adjust, bring in newer technology, try to – like in these days ramp more the Samsung QLEDs than we ramped up the regular UHD TVs more of the premium technology and so forth.

So, it's a headwind we're used to. You have to change your value proposition, adjust your pricing, adjust your screen sizes, adjust what kind of technology you carry with. We've been through this a number of times. I won't say it's not a bit of a headwind but it's one we certainly have overcome and will continue to overcome not only with the way we [ph] handled the electronics, be able (00:23:24) with other new product categories.

Bradley Thomas
Analyst, KeyBanc Capital Markets, Inc.

Q

Very helpful. Thanks so much, Mitch.

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc.

A

Thanks, Brad.

Operator: Our next question comes from the line of Kyle Joseph from Jefferies. Your line is open.

Kyle Joseph
Analyst, Jefferies LLC

Q

Hey. Good morning, guys. And I'll echo Brad's statements about the solid quarter and solid end to the year. I'd just like to get your sense for – on the Preferred Lease business, you gave us plenty of color about the margins in 2020 but as we step back and look at that from a longer term perspective, can you give us a sense for where you think that overall EBITDA margin shakes out and maybe first some context just to compare how it eventually looks versus the Rent-A-Center side of the business?

Maureen B. Short
Executive Vice President & Chief Financial Officer, Rent-A-Center, Inc.

A

Sure. Thanks, Kyle. So thinking about the EBITDA margins within the Preferred Lease segment, we expect low-double digit guidance for 2020 for that segment, similar to the EBITDA performance we had this year. We continue to invest in the business and so that negatively impacts EBITDA margin, but as we scale up the business, we've made some investments. We've purchased Merchants Preferred, which had a lower EBITDA margin. And as we integrated that within the business, with a full quarter of performance in Q4, that was slightly dilutive to EBITDA margins. But as we scale up that business and recoup the return on our investments early in the year, that should start to build over time. So we expect an ongoing EBITDA rate of low-double digits. Relative to the Rent-A-Center Business which is around 15%, as you know we've had significant cost savings initiatives within that business segment and even expect another $10 million to $15 million this year.

Kyle Joseph
Analyst, Jefferies LLC

Q

Got it. That's really helpful. Appreciate that. And I know you've just integrated the business but can you give us a sense for the pipeline of retailers there, describe some of the – are they nationwide, are they more regional players? And then in terms of merchandise, are you guys looking to diversify the merchandise that you guys are partnered with there?

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc.

A

Yeah. Good morning, Kyle. Yeah. I'd say, yes, all of those actually have yes to – the pipeline looks really good, the pipeline for national players is starting to define itself. Again, we hired our national accounts person three weeks ago but he hit the ground running because he has done this for – he was doing this for TD Bank before we hired Paul Hamilton. So, not that we weren't working on before that either.

So, yeah, the pipeline is good in all accounts both in local, regional and national accounts. So, we're pretty excited. And again, I'll remind you, we don't – the forecast doesn't necessitate a national player to hit the kind of numbers we're talking about over the next couple of years, just need to keep going on the regional players. So, we don't even have to have one but I feel really good that we will get some national accounts over the next year or two.

Kyle Joseph
Analyst, Jefferies LLC

Q

Got it. And then one last one from me a little bit on semantics here. But the CapEx on the Preferred Lease segment was low in 4Q. Are the investments in that business did not quantify the CapEx in the fourth quarter? I'm just kind of trying to reconcile that with your CapEx outlook for 2020.

Maureen B. Short
Executive Vice President & Chief Financial Officer, Rent-A-Center, Inc.

A

Yes. So, most of the investments we've made so far with the integration of Merchants Preferred have been to grow of sales team. There has been some technology investments, a lot of which will continue to grow in 2020, but some of that is operating expenses, some of that is CapEx, but a lot of what we've seen so far have been related to people which are operating expenses.

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc.

A

Yeah. And enhancing the technology isn't always CapEx, right? A lot of it is operating expense when you're enhancing something that already exists.

Kyle Joseph
Analyst, Jefferies LLC

Q

Yeah. No, that makes perfect sense. That's it for me. Thanks very much for the time in answering my questions.

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc.

A

Thanks, Kyle.

Maureen B. Short
Executive Vice President & Chief Financial Officer, Rent-A-Center, Inc.

A

Thanks, Kyle.

Operator: Our next question comes from the line of John Baugh from Stifel. Your line is open.

John Allen Baugh
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Thank you. Good morning and congrats on the fourth quarter and year. Jump right into it. Could you just tell us where in the store business the CE percentage is right now, Mitch, and maybe how that changed in 2019 versus 2018?

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc.

A

It's about 15% of the revenue. And at the end of 2018, it was roundabout 10%. So – I'm not very good at math, but that's what – about 15% growth in that segment, when it went from 10% to 15%. So, continues to grow and we talked about a little bit last quarter how the number of orders that come in off the Web are kind of a leading indicator. And when we look at the Web orders in the fourth quarter, which is about 17% of all of our lease-owned agreements, that translates and is heading towards being 20% of the revenue in the future. So 15% of revenue in the fourth quarter, but the agreements we wrote was 17% of agreement, so it just continues to build the – writing the agreement obviously is more of a forward-looking indicator towards higher than 15% revenue going forward. So, it looks to me like that will be 20% pretty soon.

John Allen Baugh
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. So I'm sorry, that was e-commerce that you were talking about there. I was asking about the mix of products sold, furniture, appliances versus consumer electronics in the store business 2019 versus 2018.

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc.

A

Sorry about that. I guess I heard the wrong...

John Allen Baugh
Analyst, Stifel, Nicolaus & Co., Inc.

Q

That's okay. That's okay.

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc.

A

I've been watching so many of these politicians, I just answered the question I wanted to answer rather what you asked [indiscernible] (00:29:28). But, no, sorry, it was about CE. So, you've talked about the headwinds and consumer electronics?

John Allen Baugh
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Yes.

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc.

A

Yeah. We're down a little bit in that category. But again and you know, John, we've done this together for a long time. You've followed us a long time. You have to – you stop carrying in the 32-inch TVs and stop carrying 40-inch TVs and just get bigger. When those TVs become $200 at – so, it's like [ph] BestBuy (00:30:01), you don't carry them anymore and you just move up the screen size. You start to mix in the QLED from Samsung and then Nano Cell from LG and that kind of stuff and minimize the disruption of the deflation. And then we're still [ph] within (00:30:17) 25% range in consumer electronics.

So, we've done it before when you have to adjust from – I had to adjust from two TVs to – when those went out of style back in the 1980s and early 1990s. So, we've done this a few times. So, we know how to do it. It doesn't mean it's not a bit of a headwind, it's just you can make [indiscernible] (00:30:40) headwind with your value proposition, your mix. And then we're [ph] doing in (00:30:44) another category, testing a lot of categories as I mentioned like tires and handbag and so forth, but it's running above – and maybe the short answer to your question is running about 25% of our revenue.

John Allen Baugh
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Great. Thank you for that. And then Maureen, I think you mentioned something about a 20% invoice growth in Preferred Lease in 2020. Did I hear that right? Is that comparing like the old Merchants Preferred organically or help me define that number?

Maureen B. Short
Executive Vice President & Chief Financial Officer, Rent-A-Center, Inc.

A

Yeah. The 20% is the organic growth expected in 2020 in that business. As you know, we bought Merchants Preferred in August and we'll also benefit next year from a full year of Merchants Preferred. So, we [ph] wanted to (00:31:35) isolate the impact of just the organic growth.

But just to help you, we ended the year with about $750 million in revenue in Preferred Lease. If we would have had Merchants Preferred a full year, it would have equated to another $50 million of revenue. So, starting the year at $800 million, it's about a 20% organic invoice volume growth. So the total growth overall for that segment will be higher than 20% because we'll also have the full year benefit of Merchants Preferred but organically we expect 20% invoice volume growth.

John Allen Baugh
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Got it. So, the staffed model will grow as you said maybe low-single digits. And then, to get to that guidance you gave Preferred Lease, the rest sort of combination of picking up pro forma which you didn't own, for Merchants Preferred as well as the organic growth there.

Maureen B. Short
Executive Vice President & Chief Financial Officer, Rent-A-Center, Inc.

A

The staffed business is actually expected to grow double digits as well...

John Allen Baugh
Analyst, Stifel, Nicolaus & Co., Inc.
Q

It is.

Maureen B. Short
Executive Vice President & Chief Financial Officer, Rent-A-Center, Inc.
A

[indiscernible] (00:32:36) slightly below Merchants Preferred but overall it's also growing double digits. We're benefiting in the staffed business from adding additional functionality, technology, integrating with their POS systems and other application, portals, as well as growing the e-commerce business for our retail partners.

John Allen Baugh
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Okay.

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc.
A

Yeah, it grew – I think it grew 15% in the fourth quarter in the staffed model, John.

John Allen Baugh
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Okay. That's interesting. Okay. And then you mentioned Paul coming onboard. Where there other leadership changes that occurred within Merchants Preferred or Preferred Lease? And any specifics of actions taken to help us think about the new tools in your tool bag in that side of the business?

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc.
A

Well, certainly added a lot of people, through an integration some people. Some people – a lot of people get added, some people leave and so forth like any integration. The other thing I'd add is we added a board member, same press release we sent out about Paul Hamilton joining us. We added a board member here recently that has a lot of experience in the retail business – retail partner business, payment solution business. Glenn Marino was with Synchrony for a number of years, a top executive at Synchrony. So he just joined our board and – so we're just adding a lot of people to help us in that part of the business and then a lot of salespeople as well.

John Allen Baugh
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Okay. Great. Thank you. Good luck.

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc.
A

Thanks, John.

Operator: Our next question comes from the line of Bobby Griffin from Raymond James. Your line is open.

Robert Griffin
Analyst, Raymond James & Associates, Inc.

Q

Good morning, everybody. Thank you for taking my questions and let me add my congrats to a solid all-around year for you guys.

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc.

A

Thanks, Bobby.

Maureen B. Short
Executive Vice President & Chief Financial Officer, Rent-A-Center, Inc.

A

Thanks, Bobby.

Robert Griffin
Analyst, Raymond James & Associates, Inc.

Q

So I guess first I want to talk on the Lease Preferred (sic) [Preferred Lease] (00:34:33). Can you maybe talk a little bit about what some of your legacy Acceptance Now customers are doing, are you seeing some of them switch to the virtual and hybrid model when they used to be staffed or they are kind of integrating the two? Any commentary there would be great.

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc.

A

There is a few conversions mostly in the lower volume staffed stores, where it might be better for everybody to go more hybrid like just weekend labor or totally virtual. Our largest customers like I mentioned that were five out of the six largest conventional furniture retailers, they're pretty much the same because the volume is such that we need to stay staffed, pretty much bell to bell whether they're open, companies that you saw on the slide, like Bob's and Rooms to Go and Value City and so forth. And actually those are staffed bell to bell and will continue to be. Now, some of the technology enhancements make us more efficient. Some of the e-com enhancements can grow the business more from the customers going on their websites, so there's enhancements being made there, but those will stay staffed. They just do a lot of volume per location.

Robert Griffin
Analyst, Raymond James & Associates, Inc.

Q

Okay. That's helpful. And Maureen on the additional cost savings, I might have missed in your prepared remarks, but additional cost savings in the Rent-A-Center Business, can you maybe give a little color on what areas of operations you guys have identified for the incremental $15 million this year?

Maureen B. Short
Executive Vice President & Chief Financial Officer, Rent-A-Center, Inc.

A

Sure. The large piece of our cost savings initiative is optimizing the number of vehicles we have in our Rent-A-Center stores. We're also investing capital in new more modern technologies to streamline the store network, which will increase the speed and functionality for our co-workers serving our customers, as well as decreased costs over time from the lower monthly spend. So, those are the – mainly it's reducing the fleet or the vehicles and reducing the network costs in our stores.

Robert Griffin
Analyst, Raymond James & Associates, Inc.

Q

Okay. That's helpful. And then lastly, just a quick modeling question for me. Can you provide the store count across the business units at the – as at the end of 12/31/2019 for us to tune up our models?

Maureen B. Short
Executive Vice President & Chief Financial Officer, Rent-A-Center, Inc.

A

Sure. In the Rent-A-Center Business, we ended the year with 1,973 corporate US stores, 998 Preferred Lease staffed locations, 123 Mexican locations and 372 franchise locations.

Robert Griffin
Analyst, Raymond James & Associates, Inc.

Q

Perfect. Well, thank you for the detail. Best of luck in 2020.

Maureen B. Short
Executive Vice President & Chief Financial Officer, Rent-A-Center, Inc.

A

Thanks a lot, Bobby.

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc.

A

Thanks, Bobby. I'd also add to that before we get to the next question. Maureen had mentioned in her prepared comments, you were asking about the store counts, Bobby, but she's added the share count number in her prepared comments. So, we need to make sure people heard that so that – because our – as you noticed, the EBITDA numbers relative to consensus estimates were – are higher and not so much the EPS higher in 2020 compared to the Street because the share count number being used by a lot of the analysts is not updated. And if – when you use the right share count with our profit, there – our EPS guidance is higher than where the Street is. So, make sure we get the right share count which was what again, Maureen?

Maureen B. Short
Executive Vice President & Chief Financial Officer, Rent-A-Center, Inc.

A

Ended the quarter at 56.6 million and we're expecting it to be 57 million diluted shares outstanding in 2020.

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc.

A

Yeah. If you don't use enough, then EPS was – even though we guided higher profit, the EPS came out about the same as what the Street was because the number was too low in some cases and that's – that mostly is just stock performance, a little bit on the Merchants Preferred stock we gave, but as the stock goes up, more of the – there's more shares to be counted based on the employee incentives and what we do with Merchants Preferred. So just to sort of remind you there besides the store count, Bobby.

Robert Griffin
Analyst, Raymond James & Associates, Inc.

Q

Absolutely. Thank you. Thank you for that, Mitch, and best of luck going forward.

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc. A

Thank you.

Operator: Our next question comes from the line of John Rowan from Janney. Your line is on open.

John Rowan
Analyst, Janney Montgomery Scott LLC Q

Good morning, guys.

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc. A

Good morning, John.

John Rowan
Analyst, Janney Montgomery Scott LLC Q

Mitch, I was going to give you an opportunity to talk about the share count on my question, so here we go again. Can you remind me – in the deck it shows $220 million of repurchase authorization. Can you remind me where that comes from? Is that the accelerated buyback program? What are the covenants around utilizing it? I just want to – I used some repurchases in my model as well and I just want to make sure that we're bracketing how we look at those correctly versus how the program functions and what the covenant restrictions are?

Maureen B. Short
Executive Vice President & Chief Financial Officer, Rent-A-Center, Inc. A

Sure. The $220 million was authorized by the board several years ago. We did do an accelerated share repurchase plan several years ago. Don't anticipate that at this point, but it was a decision that was made several years ago. We have plenty of capacity in our debt facility but that ended up something that the board has opined on and believes that share repurchases could be a part of our capital allocation strategy. We actually did repurchase a few shares in the fourth quarter and are open to that in 2020 but, as a reminder, our guidance does not include any share repurchase activity for 2020.

John Rowan
Analyst, Janney Montgomery Scott LLC Q

Your – but the accelerated purchase program wouldn't preclude you from going into the market at opportune times, it doesn't require like a block purchase or anything, correct?

Maureen B. Short
Executive Vice President & Chief Financial Officer, Rent-A-Center, Inc. A

No, that – there is really no stipulation around share repurchases that we're under at this time. The accelerated share repurchase plan was something we did a one-time thing several years ago. So that has nothing to do with our go-forward strategy of potentially buying back shares opportunistically.

John Rowan
Analyst, Janney Montgomery Scott LLC Q

Okay. And then as we look at cash flow in 2020, right, so we can balance out the possibility of repurchases and the share count issue. The [indiscernible] (00:40:31) the free cash flow guidance that does not include the $35 million for the sale leaseback, correct? Because I can't remember, was that closed at the very end of this last quarter or was that closed in January of this year?

Maureen B. Short
Executive Vice President & Chief Financial Officer, Rent-A-Center, Inc.

A

It was closed in the fourth quarter. So by the end of...

John Rowan
Analyst, Janney Montgomery Scott LLC

Q

Okay, so wouldn't be in guidance for next year, okay. Tax season, some indications are the rates are – refunds are a little slow. It's probably too early to draw a conclusion. I did see something on the IRS website stating that some of the earned income tax credits and affordable childcare tax credits might get pushed out into the very beginning of March which is a little bit of a delay versus last year. I just want to make sure that that type of delay doesn't push refunds out past the early payout options for your lease contracts?

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc.

A

Yeah. Good question, John. We don't – it is a little – it does appear like it's going to be a little slower, maybe a week slower than last year but doesn't appear that it's going to cause any issue relative to how we perform in the quarter or how the customer performs. So, I wouldn't see that as – it's a little bit slower but I don't think it's going to be an issue based on the way it normally works. And here we are later in February, I can tell you that even through January I mean business remained solid and we're on our plan.

Maureen B. Short
Executive Vice President & Chief Financial Officer, Rent-A-Center, Inc.

A

And John...

John Rowan
Analyst, Janney Montgomery Scott LLC

Q

Okay.

Maureen B. Short
Executive Vice President & Chief Financial Officer, Rent-A-Center, Inc.

A

...since we have [indiscernible] (00:41:56) cash period now relative to others and versus even a year or two ago, we're not up against that period where people sign up for agreements over Black Friday and then you come close to not being able to exercise. If there is a delay in tax refund, that's not an issue for us.

John Rowan
Analyst, Janney Montgomery Scott LLC

Q

That's right. When did you – did you extend that last year or was it even the year before where you changed? Was it – went from like 90 days to maybe 120 or something like that?

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc.

A

Yeah. In early 2018 when I came back, we went from 90 to either 120 or 180 depending on the product. It varies. So, yeah, Maureen made a great point. It really wouldn't matter a week here or there. And this will be our second tax season under that. We're two full years into that and that's working. Obviously, the value proposition's working pretty well.

John Rowan
Analyst, Janney Montgomery Scott LLC
Q

Okay. And just last housekeeping question. What's the correct blended rate to use on debt?

Maureen B. Short
Executive Vice President & Chief Financial Officer, Rent-A-Center, Inc.
A

It's around 6%.

John Rowan
Analyst, Janney Montgomery Scott LLC
Q

Okay. And actually one more question, one more housekeeping, the tax rate for 2020?

Maureen B. Short
Executive Vice President & Chief Financial Officer, Rent-A-Center, Inc.
A

The tax rate will be similar to this year around 24% – 24% to 25%.

John Rowan
Analyst, Janney Montgomery Scott LLC
Q

All right and thank you very much.

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc.
A

Thanks, John.

Maureen B. Short
Executive Vice President & Chief Financial Officer, Rent-A-Center, Inc.
A

Thanks, John.

Operator: Our next question comes from the line of Anthony Chukumba from Loop Capital Markets. Your line is open.

Anthony Chukumba
Analyst, Loop Capital Markets LLC
Q

Good morning and thanks for taking my questions. So, first question, you mentioned some of these new product categories, specifically you mentioned jewelry, handbags, tires, I think there was a fourth one I'm forgetting. Just two questions on that. First – I guess the fourth one was tools.

Two questions on it. First off, is that in all stores at this point? And then, second off, if you can just give some early color in terms of what you're seeing there in terms of customer acceptance and any sort of market differences in terms of like skips/stolens on those products? Thanks.

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc.

A

Sure, Anthony. I'll answer part of your question, and the rest I'll be careful not to give our competition too much information. Handbags and tools have been rolled out nationwide. Tools, generators, handbags are nationwide. After we did a test, they were rolled out nationwide. Tires and jewelry are still in test, the recent test that we just started.

As far as any other data around how they're specifically performing, like I said, I think I'll keep that in my pocket.

Anthony Chukumba
Analyst, Loop Capital Markets LLC

Q

Okay. Fair enough. And then, I guess my second question, is there any particular reason that you didn't have the store counts in your press release? Because typically you have those in your press release.

Maureen B. Short
Executive Vice President & Chief Financial Officer, Rent-A-Center, Inc.

A

Yeah. We decided just to include them in our 10-K and 10-Q going forward. With the addition of virtual and the complexity of hybrid locations, like a potentially even shift between a virtual location to a staffed at any given point within a quarter, it just complicates the numbers. We'll continue to show the staffed locations, the Rent-A-Center stores, franchising in Mexico. Going forward, it's just a less relevant number for us. When it comes to the Preferred Lease segment, we use the metric of invoice volume to really understand what the business is doing rather than location count.

Anthony Chukumba
Analyst, Loop Capital Markets LLC

Q

Got it. Okay. Thank you.

Maureen B. Short
Executive Vice President & Chief Financial Officer, Rent-A-Center, Inc.

A

Thanks, Anthony.

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc.

A

Thanks, Anthony.

Operator: Our final question today comes from the line of Vincent Caintic from Stephens. Your line is open.

Vincent Caintic
Analyst, Stephens Inc.

Q

Hey. Thanks. Good morning. First, on Preferred Lease, so [indiscernible] (00:45:34) good guide for 2020, up 18% year-over-year at the midpoint. I guess two questions. First, is there a cadence over the course of 2018 (sic) [2020] (00:45:44) that we should expect it to ramp up or is it kind of an even 18% throughout the year? And then, secondly, it was great that you highlighted that you already have national account all in furniture. However, I'm just wondering is it a big lift to go from national furniture retailers to becoming – to go in for a broader set of retailer categories?

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc.

A

I'll start with that one and let Maureen talk about the cadence. No, I don't see it as a big lift, Vincent, to get in other verticals on the Preferred Lease side. We've done really well with the bigger furniture accounts. But, no, I don't see it as big lift. I think like – I'm sure you're familiar, the biggest change when you get into different verticals is just going to be your decision engine, you risk engine and you might tighten it in one category versus another. That's all. But it's not a big lift other than – presumably you have to tighten it a little more in one category versus another.

Maureen B. Short
Executive Vice President & Chief Financial Officer, Rent-A-Center, Inc.

A

Just to add on to that. I mean, we've got – one thing that national accounts are looking for is a public company with a strong balance sheet to be able to fund future growth and we absolutely have that. So, it should be, like Mitch said, not too big of a stretch to go into someone that is fairly similar in size to some of these other large retail partners that we currently do business with.

And then to answer your question about Preferred Lease and how the cadence of growth will show through 2020, it does build throughout the year. It's a portfolio business, so as we add additional retail partners, it will compound so that the second half of the year is higher growth than the first half of the year.

Vincent Caintic
Analyst, Stephens Inc.

Q

Okay. That's very helpful. Thank you. One more question. So on the Rent-A-Center core business stores, just seem the revenue and EBITDA guidance kind of flattish for 2020. Is that entirely from refranchising efforts? And if so, just kind of wondering what you're thinking about refranchising and if you could remind us kind of the EBITDA lift that comes from refranchising? Thank you.

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc.

A

Yeah. Vincent. I think that is the difference, refranchised about 100 stores last year so you think about that as almost 5% of our store base got refranchised when you think about the revenue impact of that. And going forward, as we've said very opportunistically – couple years ago, we were talking about franchising more. Certainly, the company was in a different position. As the position we're in now, it's going to be used very opportunistically. Certain markets if we think a franchisee can do better or for whatever reasons but just opportunistically. So I don't see – it's not a big part of our strategy going forward but it does remain part of our strategy from an opportunistic standpoint.

As far as EBITDA going forward, there hasn't been much impact. The EBITDA is down a little bit because of refranchising. That would have some negative impact. I talked about the revenue. But if you refranchise opportunistically, the little profit stores, you don't give up that much EBITDA. Our royalty rates run between 5% and 6%. So if you're selling the fourth quartile stores, you're not going to be that far off from an EBITDA standpoint. It's mostly revenues, some EBITDA, but you [indiscernible] (00:49:19) somewhere else because you've got capture of the stores and then you get return based on what you do with that money, right? So – but overall, it's more of a revenue impact, let's say, Maureen than EBITDA impact when you just look at the Rent-A-Center Business segment.

Maureen B. Short
Executive Vice President & Chief Financial Officer, Rent-A-Center, Inc.

A

Right.

Vincent Caintic
Analyst, Stephens Inc.

Q

Great. Very helpful. Thanks so much.

Mitchell E. Fadel
Chief Executive Officer & Director, Rent-A-Center, Inc.

A

Thanks, Vincent.

Maureen B. Short
Executive Vice President & Chief Financial Officer, Rent-A-Center, Inc.

A

Thanks.

Operator: We have no further questions. I'll turn the call back to Mitch Fadel for closing remarks.

Mitchell E. Fadel

Chief Executive Officer & Director, Rent-A-Center, Inc.

Thank you, Lisa, and thank you everyone for joining us this morning. We were glad to deliver very positive results for 2019 and for the fourth quarter specifically. And I want to thank all the – the entire team, the 14,000 or so co-workers out there in the stores, in the kiosks, here in the field support center. That was a great effort last year by many, many people, and we will work just as hard in 2020 to do it again. Thank you, everybody.

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.