06-Aug-2020

Rent-A-Center, Inc. (RCII)

Q2 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and thank you for holding. Welcome to Rent-A-Center's Second Quarter Earnings Conference Call.

As a reminder, this conference is being recorded, Thursday, August 6, 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 and Real Estate.

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. Good morning everyone and thank you for joining us. Our earnings release was distributed after market close yesterday, and it outlines our operational and financial results for the second quarter of 2020. 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. These factors are described in our earnings release issued yesterday, as well as in the company's SEC filings. Rent-A-Center undertakes no obligation to publicly update or revise any forward-looking statements.

This call will also include references to non-GAAP financial measures. Please refer to our second quarter earnings release, which can be found on our website for a reconciliation of any non-GAAP financial measures discussed on this call to the most comparable GAAP financial measures.

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 voice over to the presentation shown on the webcast that can be found on our website at investor.rentacenter.com.

So, starting on slide 3, we are very pleased with our performance in the second quarter, which was significantly above expectations. We marshaled our resources that made extensive changes to navigate the challenges of the pandemic. Our agility, speed, strong execution in investments to support customers really paid off and I believe we are now even better positioned for the future. The safety of our coworkers and customers has remained our top priority and I could not be more proud of our team for providing our customers safe access to essential products during this difficult period.

All of this enabled the company to exceed expectations growing the top line by over 4% and increasing earnings per share by approximately 33% versus the second quarter of 2019. The Rent-A-Center Business increased same-store sales by almost 8% versus last year. And this is our 10th consecutive quarter of positive same-store sales. Consolidated adjusted EBITDA increased 12.6% and we achieved the highest adjusted EBITDA margin in years.

Revenue performance was positive versus last year and each month of quarter accelerated throughout the quarter, present testament to the critical role we serve for serve customers, our recurring revenue model and the resiliency of the business model. We feel great about our core assets and omni-channel strength and believe we're well-positioned to continue to drive comps, as we capture share.

Preferred Lease achieved 8% revenue growth and 25% invoice volume growth in Q2 despite extensive store closures in the quarter related to pandemic. Approximately, two-thirds of our Preferred Lease locations were temporarily closed due to shelter-in-place orders, affecting our retail partners. The business then experienced a strong acceleration in May and June and we expect growth in the back half the year to be similar to our original estimates prior to the pandemic. Our performance is a validation of our investment in that channel.

Now turning to slide 4, the work we've done to evolve the business and our strong position, starting in the year, enabled us to grow while offsetting headwinds from the coronavirus. As we sit here today, we expect 2020 within the range of our pre-COVID guidance for revenue, adjusted EBITDA and non-GAAP diluted EPS, while increasing our free cash flow guidance.

Our overall portfolio balances for both businesses are expected to end the year, well-positioned for growth in 2021 and that's really a remarkable feat. And it's not contingent on additional government stimulus. I'm extremely proud of our team in all they're doing every day to meet our customers' needs. While the economic path is hard to predict, the investments we're making in e-com, digital payment options and virtual lease-to-own has improved both the resiliency of our model and our ability to grow sales and earnings.

Our business model is optimized for the current economic environment and the things we're doing today to improve the experience for our customers and retail partners will shape Rent-A-Center for years to come. As you can probably imagine, we're truly excited about the future.

So, starting on slide 5, let's start with the Rent-A-Center Business, which had a resilient top line performance throughout the shutdown. As in past recessions, tighter credit reduced options for customers and we think we're taking an outside share of that. Same-store sales increased 7.8% with positive comps for all months. Our teams have done an incredible job continuing to operating as an essential business in leveraging e-commerce.

Stimulus drove higher early payouts and that had some modest impact on margins, as Maureen will detail, yet customer activity has remained strong, demand for products to improve the home is trending well with our strongest performance in furniture and appliances, one we're very encouraged by what we're seeing.

Investments in technology are also driving benefits across the organization. E-commerce revenue increased 60% in the quarter to reach 19% of total Rent-A-Center Business revenue. Our e-commerce customers are generating more profit for Rent-A-Center than our brick and mortar customers and we expect the business to account for over 25% of Rent-A-Center sales by the end of 2020.

[indiscernible] (00:06:13) playing out a robust growth in e-commerce is having minimal impact on skip/stolen losses, which we expect for 2020 to be within the range we anticipated prior to the pandemic. As a reminder, that's approximately 4% of revenue. And based on what we know today, we don't expect COVID, higher unemployment rates or the recession environment to have a material impact on skip/stolen losses for 2020, which again underscores the value of the lease-to-own business model during difficult economic times.

Collections are also benefiting from investments. An increasing number of our customers are now using digital payment options and this is improving our early stage past due accounts. We intend to continue to invest in strategic priorities that we believe has a potential to steepen our long-term demand curve by improving the customer experience.

Moving on to Preferred Lease on slide 6. We're pleased with our performance here as well. As I mentioned, invoice volume was up 25% in the quarter versus last year. Collections benefited from investment in digital payments systems and leveraging our centralized call center. The majority of our Preferred Lease customers now use digital payment solutions. Store reopenings positively impacted the business and we're seeing significant demand for household goods, [indiscernible] (00:07:29) for example is seeing strength as customers adapt and invest in their homes to accommodate the shift in work patterns and spend more time at home.

Our sale team is seeing increased interest in retailers partnering with Preferred Lease and we believe additional product verticals related to tires, fitness and jewelry could be a natural fit for our model. In addition to numerous product verticals, we're also excited about the prospect of adding an additional national account by the end of the year.

As with the Rent-A-Center score of credit aside and across the competitive landscape, our approval rates are up and are staffed in virtual locations and we're having higher credit quality customers, which should allow us to drive revenue and yield as we increase market share. Adjusted EBITDA was affected by the significant partner store closures we experienced in late March and through the middle of the quarter. We experienced a makeshift of virtual as well as higher earlier payouts driven by the government stimulus programs. We do expect this to normalize in the back half of the year.

During the quarter, we added new leadership to Preferred Lease in June, with the appointment of Jay Hogg, as Executive Vice President of Preferred Lease. Jay has a proven track record as a leader and innovator in Financial Services and Financial Technology and we're excited about the new perspectives and key relationships he brings.

We also struck a partnership with ChargeAfter, which is integrating Preferred Lease into the platform to provide for lease loan for e-commerce and brick and mortar customers. We're confident we can achieve the long-term revenue and profit targets we've laid out for the business. As you'll recall, that includes our goal to achieve $1.2 billion of Preferred Lease annual revenue by 2022.

Our revenue and EBITDA performance generated robust cash flow in the quarter and we're well-positioned with zero net debt and strong liquidity to move forward on our strategic plans. Our top priority is to use our strong balance sheet to grow the Preferred Lease segment alongside investments to advance our digital capabilities in both Rent-A-Center and Preferred Lease.

The changes to the way our customers live and work are here to stay. Our focus will remain on strategically managing our business to increase value for customers and retail partners. The leadership changes we made in 2020 support our view that optimal strength comes from a cohesive operating strategy, one that leverages all parts of the organization and think holistically about the best way to serve lease-to-own customers.

Our two primary operating segments share best practices to compete more effectively in a strong cash flow from the Rent-A-Center Business, supports growth in the Preferred Lease business. We have a strong balance sheet and best-in-class compliance and technology to support digital and partner growth. We also intend to continue to return cash to shareholders. Our dividends has yield of approximately 4%, and we'll continue to evaluate share repurchases as well. We'll also continue to evaluate M&A that might advance our strategy.

I'd like to thank our co-workers, franchisees and retail partners for your dedication to serve customers during the challenging time. Our stronger results would not be possible without each of you.

And with that, I'll turn it over to Maureen to discuss the second quarter financials in more detail.

Maureen B. Short

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

Thanks, Mitch. As you can see on slide 7, total revenue grew 4.2% in the second quarter versus last year. Adjusted EBITDA increased 12.6%, both significantly exceeded our guidance for each to be down less than 10%. Adjusted EBITDA margin increased 80 basis points versus last year. Non-GAAP diluted EPS was 32.8%, as compared to our guidance of flat versus last year. The solid performance, tight management of expenses and favorable working capital reductions resulted in strong operating cash flow of $207 million and we ended the quarter with zero net debt.

Digging a little deeper into the segment performance, on slide 8, and starting with the Rent-A-Center Business, same-store sales increased 7.8% with positive comps in each month of the quarter as compared to last year. Two-year same-store sales were 13.4% for Q2. Customer payment activity was strong in the quarter and demand was better than last year, mainly driven by higher customer retention. Group's margin in the Rent-A-Center Business was lower by 80 basis points in the second quarter versus prior year, primarily due to higher early payouts, as customers took advantage of government stimulus program to obtain ownership of leased products.

It's important to note that payouts increased without significantly impacting the lease portfolio since demand remained strong and the portfolio ended the quarter up 4% over last year. Skip/stolen losses for the Rent-A-Center Business were 3.7%, up 50 basis points versus last year with no incremental reserve adjustment related to COVID-19, given the strong customer payment activity and exceptional execution in the field.

For the full year, we still expect skip/stolen losses for the Rent-A-Center Business to be approximately 4% of revenue, up slightly versus last year, due to growth in e-commerce. As Mitch mentioned, we came into the quarter with an aggressive plan to mitigate the impact of COVID-19 that included a range of expense initiatives including furloughs and rent abatements. As a result, we were able to offset all of the impact on the bottom line from the pandemic in the Rent-A-Center Business within the quarter.

Turning to Preferred Lease, as Mitch mentioned, invoice volume in the quarter was up 25%, despite the majority of our Preferred Lease staff locations being temporarily closed during the quarter due to the shelter-in-place directives from the pandemic. Preferred Lease revenue was up 8.4% versus last year and the portfolio ended the second quarter, up 15% over the same period last year.

As we outlined in the first quarter, Preferred Lease benefits from its recurring revenue stream has a higher percent of digital payments and higher ownership rates than the Rent-A-Center Business. We also made a number of changes to increase efficiencies by leveraging our centralized call center, which should reduce our ongoing labor costs. Preferred Lease skip/stolen losses were affected by the pandemic since many of our retail partners were fully closed due to not being considered an essential business like our Rent-A-Center our stores. Skip/stolen losses were 18.4% of revenue versus 9.6% last year.

In addition to booking our typical reserves that reflect current levels of loss expectations, we increased our skip/stolen reserves by $5.6 million in the second quarter to reflect our best estimates for 2020 losses driven by COVID-19. We do not expect any further COVID related reserve adjustments in the back half of the year. Excluding these COVID-related losses, skip/stolen losses would have been approximately 15.4% of revenue for the second quarter, up from last year, partially driven by the mix shift of the business towards the virtual model.

During the back half of 2020, our skip/stolen losses are expected to be between 12% and 13% of revenue for the Preferred Lease business. Adjusted EBITDA margin for Preferred Lease with lower than last year due to lower gross margins from higher early payouts, mainly driven by the government stimulus programs, higher loss reserves related to COVID-19 and a higher mix of the virtual business. Early payouts have a lower gross margin than rental transactions and our virtual business is expected to increase EBITDA margins, as we scale up the business by adding new retail partners.

With no adjustments to our skip/stolen reserves in the Rent-A-Center Business, and an incremental $5.6 million reserve adjustment in the Preferred Lease segment, COVID-related losses have less than a 1% impact on our overall adjusted EBITDA margin in the quarter, which demonstrates the resiliency of the business. Looking beyond the P&L, operating cash flow in Q2 was $207 million. We used available cash to pay down on our revolver to a zero balance, which brings us to zero net debt to end the quarter and $199 million in total outstanding debt.

Now turning to slide 9, as Mitch said, we're tracking to the overall consolidated guidance we originally gave in February. These expectations are same as similar retail environment to what we have today and no additional government stimulus program. Our reiterated guidance includes, on a consolidated basis, 2020 revenue of between $2.755 billion and $2.875 billion, adjusted EBITDA between $255 million and $285 million and non-GAAP diluted EPS between $2.45 and $2.85. We have also increased our guidance for free cash flow, now expected to be between $135 million to $165 million, up $30 million from our original 2020 guidance provided in February.

While we are not providing specific guidance beyond the ranges I just went over, I do want to give some color to help you think about the rest of 2020 and how our portfolios will position us to build on growth in 2021. For the Rent-A-Center Business, we expect favorable demand trends to continue and to end the year with our portfolio balance at the level we expected prior to the pandemic. Adjusted EBITDA for 2020 is expected to be up approximately 11% versus 2019.

In the back half of the year, Preferred Lease is expected to grow revenue by 10% to 12% each quarter versus last year and the adjusted EBITDA margin is expected to be approximately 10% of revenue in the back half of 2020. The Preferred Lease portfolio is expected to end the year up over 15% versus 2019 and full year 2020 invoice volumes is expected to be up approximately 25% year-over-year. The quality of our portfolio is expected to continue to benefit from credit tightening across the competitive environment.

Regarding operating expenses, we expect that labor savings will partially continue into Q3, and the benefit from structural changes to the Preferred Lease business by leveraging our centralized call center will help improve efficiency.

Now on slide 10, as of the end of the second quarter, we had approximately $206 million in cash and total liquidity of approximately $418 million. We are anticipating a working capital investment in the back half of the year due to growth in demand in the Rent-A-Center Business and Preferred Lease. We have ample capital to invest in the business and we are expecting strong cash flow in 2020 in the coming years as we benefit from improvements we've made across the organization.

Share repurchases were temporarily suspended due to the uncertainties around the pandemic that will now be made opportunistically. We have purchased $26.5 million this year, leaving $58.8 million of remaining share repurchase authorization. While we're very pleased with our performance and the resiliency of the business, there is still a tremendous amount of uncertainty related to the pandemic.

As we have demonstrated over the past few months, the management team will continue to take proactive measures as needed to successfully navigate through the pandemic. I'm optimistic about our ability to continue to drive profitable growth. I'd also like to thank our co-workers for their perseverance and commitment to serving our customers. As always, detailed income statements by segment are posted to our Investor Relations website and we anticipate filing the 10-Q later today.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from Vincent Caintic from Stephens.

Vincent Caintic
Analyst, Stephens, Inc.

Q

Thanks. Good morning and a great quarter. Starting off with Preferred Lease, just two questions here. So, first on the write-offs, and thank you for the breakup between the COVID-related impact and the non-COVID related impact. Even with non-COVID just being up 15.4%, the year-over-year jump, just wondering if you could maybe talk about of that and then maybe give an outlook for like July and August what you've seen so far?

And then for the 25% invoice volume growth, so very strong there. I was wondering if you could separate out by maybe same-store sale invoice volume growth versus the benefit from the acquisition of Merchants Preferred? Thank you.

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

A

Sure, Vincent. Good morning. Well, I'll take the last one first, that 25% invoice volume was both organic and because of Merchants Preferred, the organic was about 5%. So, did pretty good with the – on the organic side with the stores been closed, a good part of the quarter – maybe not quite half of the quarter, but close to half of the quarter. Over two-thirds of the stores are closed and the organic growth mostly out of their staff model, right, because that's the organic part was still up about 5%, so a very strong and obviously, then accelerated after that.

On the losses – excuse me, besides the COVID or let me address the COVID first. And we really – I'll address this couple of different ways, we really see this as the one time anomaly. We do see the losses normalizing in the back half of the year that the current collection metrics are very positive. One thing that happened to us you noticed in our prepared comments or in the press release, our losses in the Rent-A-Center Business were not impacted by COVID and actually in our virtual business they weren't impact either.

The staff business, with all of those locations being closed, on the staff side, close to 80% of our stores at one point were closed and we were doing collections only out of those locations in the past. And the contact center, our call center only did collections for the virtual after we bought Merchants Preferred last summer. So, the local collections was gone overnight basically. And that drove the high losses in the quarter. We switched to using the contact center or the call center in Atlanta to do the collections for us, but they took a little bit of time to convert over and obviously, the affected losses.

The good news is that not only are the metrics great now, but by converting over and we're leaving the collections in the contact center now going forward, which is the labor savings going forward, that Maureen mentioned. So, one-time anomaly cost us some losses, because we had to go from local staff collections to call center collections. But now that we've done it, the metrics are – now we've completed that the metrics are really good in July. We're confident our numbers will be normalized at the back half of the year. We talked about – Maureen talked about the EBITDA margin being estimated 10% for the back half of the year, which obviously includes losses being normalized.

And there's labor savings, because we're keeping the collections now on the call center, not going back to the localized collections. So, on the long run, that anomaly recorded in a very weird way, Vincent, is on an ongoing basis reduces our operating cost for many years to come, because we got four from the converting globalized collections into the call center. We're leaving it there and we're seeing very good positive metrics today from it. So, in the long run, it's actually $1 savings event, if I could say lot of weird things going on in this world today, but that's just another one.

Vincent Caintic
Analyst, Stephens, Inc.

Q

Perfect. Yeah.

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

A

And I would just add that the better comparison would be the sequential change, because with the acquisition of Merchants Preferred exchanged the mix of virtual versus staff. And so, in the first quarter, we were at around 12% losses. And as we mentioned at the beginning of the year, we expected it to be around 12%. So, I would compare it more sequentially than year-over-year. We also didn't take any reserve adjustment in the first quarter. I know a lot of companies ended up taking reserve changes within that first quarter and we expect the skip/stolen Preferred Lease numbers to be 12% to 13% in Q3 and Q4.

Vincent Caintic
Analyst, Stephens, Inc.

Q

Okay. Perfect. And that's very helpful color. Appreciate that. So, very nice forward look on that. The second question, Mitch, you made a comment about M&A and I'm kind of curious on what you might be thinking of bear in terms of, is it logical maybe add-on, this is stores or maybe other players who might be weaker coming to market, or a combination just sort of wondering what your thoughts are there? Thank you.

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

A

Yeah. I wouldn't comment any more specifically as you would guess than what I've already said. But I think there could be some opportunities going forward, so a little with our balance sheet. And my guess would be, or the only added color I'd say is, really, we're talking probably more on a Preferred Lease side to accelerate our strategy there than we are on the brick-and-mortar side.

Vincent Caintic
Analyst, Stephens, Inc.

Q

Okay. Got it. Thanks very much. Very helpful.

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, Vincent.

Operator: Your next question comes from Bobby Griffin from Raymond James.

Bobby Griffin
Analyst, Raymond James & Associates, Inc.

Q

Good morning, everybody. Thank you for taking my questions. Hope everyone is staying safe and healthy. First, I wanted to ask about Maureen just real quickly on the guidance. Does the guidance assume around 4% stimulus? And if we do end up getting around 4%, can you maybe just help us understand how that might impact some of the back half numbers for us in our model?

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

A

Sure. So, we did not assume additional stimulus. From what we saw in the second quarter, it did drive higher payouts, it drove better demand, mainly through customer retention, higher customer payments. And with the guidance that we provided, we assumed a more normalized level of those metrics. So, if we were to see additional stimulus, which seems pretty likely based on the discussions taken place so far, but if we do see that, we should be towards the higher end of the guidance ranges that we provided.

Bobby Griffin
Analyst, Raymond James & Associates, Inc.

Q

Okay. Very helpful. And Mitch, in our remarks you mentioned the potential of lending a national account there for Preferred Leasing, just curious if that does come to play is the scale of the organization kind of built-up and ready for that, or would there be a round of investments on the SG&A or the cost side that we would need to have as you ramp that account up?

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

A

I think we're ready for it. It'd be primarily in the virtual space anyhow which is obviously easier to scale up than what we draw on the staff. And so, we're ready for it. And I'd also from an infrastructure standpoint – it doesn't mean you don't have $1 million spent somewhere along the line, but I mean from a material standpoint, we're ready for it.

And then I'd add, it won't be foreign to us either. What we don't have some of the biggest overall names in the country, we've had national accounts for quite a while on the frontier side. If you think about rooms to go, pretty national, Bob's Furniture, Ashley, the Value City chain. So, we've got national accounts and those are primarily staff.

So, those were already to gear up for what would come from a virtual. Although virtual national account could staff some stores, the higher volume stores and that's one of our differentiators, right, is we could staff during certain periods of time or just some of their higher volume stores, higher volume meaning demographically fit for us, higher volume, maybe more subprime volume. So, we're used to this, having to staff up for national accounts versus just doing most of that virtual.

Bobby Griffin
Analyst, Raymond James & Associates, Inc.

Q

Okay. And then lastly for me, just on the organic portion, excuse me, of the Preferred Lease, when you look at kind of your customers, are you seeing better ticket growth, or is it a combination of tickets are going up and you're also gaining more customers? So, you're seeing penetration inside your accounts just move higher with what's going on in the world?

Mitchell E. Fadel

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

A

The latter. It is more penetration with tightening credit. Certainly, strong furniture demand as well from a retail partner standpoint. But with the tightening credit, we're getting a higher quality customer coming in and more of them coming in, which means we can also tighten up on the bottom end of our decisioning. Vincent was just asking about losses. So, it allows us to tighten up on the bottom end of the decision engine, because more is coming in on the top end anyhow. So, it's a really great combination for us.

Bobby Griffin

Analyst, Raymond James & Associates, Inc.

Q

Okay. It's been very helpful. I appreciate answering my questions and best of luck here in the third quarter.

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

Thank you.

Operator: Your next question comes from Anthony Chukumba from Loop Capital Markets.

Anthony Chukumba

Analyst, Loop Capital Markets LLC

Q

Thanks for taking my question. Congrats on the strong quarter. So, I just wanted to – my first question, I just wanted to clarify something in terms of the increased skip/stolens in Merchants Preferred. So, it sounded like what you're seeing, I just wanted to make sure understood this, because all these retail partner stores were closed and the collections were being done in the retail partner stores, the skip/stolens were higher. But now you're switching to centralized collections to the call center. So, that's going to be a long-term benefit, because you're centralizing those. I just want to make sure I understood that correctly?

Mitchell E. Fadel

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

A

Yeah. Remember, we're talking about when the retail partners close and we're talking about staff locations. Our retail partner closing, where we hit – where we're in there virtually, didn't change anything as far as collections. But when the staff stores close and we furloughed the people that were working out of those stores, then that was a big change to then take the collections from staff to virtual. And it took us a while.

I mean, we weren't collecting the next day from a technology standpoint. We didn't have the ability to start collecting the very next day from our contact center, because they're different systems and so forth. So, it took us a little while and causing the blip that we did not see any blip obviously in the Rent-A-Center side or the virtual Preferred Lease side.

So, again, the resiliency of a lease versus a sale, but we did see the blip in staff because our collections want to wait for a while until we got converted over the contact center. So, that caused the blip. But now, we found that we can run just a good metrics – actually better metrics today by running out the contact center and that has the long-term benefit.

Anthony Chukumba
Analyst, Loop Capital Markets LLC

Q

Got it. And I just have one to confirm. But now when – we're not going back to having the people in the store do the collections, right. It's just sense wise that the way we're going forward?

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

A

The people – less people went back into the stores. That's delivered savings. People still on back into the staff stores to handle the sales, but we didn't have...

[indiscernible] (00:33:13)

Anthony Chukumba
Analyst, Loop Capital Markets LLC

Q

But they're not going to collect, and that's what I'm asking with collection specifically.

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

A

Correct. Correct.

Anthony Chukumba
Analyst, Loop Capital Markets LLC

Q

Okay. Okay. I just want to clarify that. All right. Thanks so much. Keep up the good work, guys.

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

A

Thanks, Anthony.

Operator: Your next question comes from Kyle Joseph from Jefferies.

Kyle Joseph
Analyst, Jefferies LLC

Q

Hey, good morning. Thanks very much for taking my questions and definitely echo the sentiments of others, congratulations on a good quarter and very impressed you guys were able to reinstate guidance in spite of everything that's happened so far in 2020. I wanted to start on Preferred Lease. You talked about your long-term revenue growth outlook there. I just kind of want to get a sense for how you foresee EBITDA margins trending over time. I appreciate the color you provided on the EBITDA margin in the back half of the year. But just as the business ramps towards $1.3 billion of revs over the next few years, how you see EBITDA margins trending?

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

A

Yes, Kyle, we expect EBITDA margins at approximately 10%, as we mentioned in the back half of the year. And then as we scale that virtual business, we expect to increase gross margin to 12% to 15% over time. As we increase the revenue, there has been the investment in the technology and the infrastructure. So, as we scale up the business, we expect pretty significant margin expansion within that business to continue.

Kyle Joseph
Analyst, Jefferies LLC

Q

Got it. Very helpful. And then, one other on Preferred Lease. Can you guys talk about the pipeline and pipeline conversion, given where approaching – well, not really, but it's been less than a year since you integrated the business. So, give us a sense for the pipeline there and then any changes in demand from retailers for the virtual rent-to-own product, given COVID disruption?

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

A

Sure, Kyle. And good morning to you. The pipeline is strong. As you would imagine with credit tightening, those who don't have a lease-to-own option in their store, or even those who do are looking for gains in that category, as things tighten above them. Depending on the category, there's demand there, but it's tougher to get people approved. So, I'd say, our pipeline is better today than before the pandemic for those reasons, both at local, regional and national level.

So, it's really exciting. And like I said, looking for lease-to-own opportunities that they don't have already have one, or even if they have one, because we have a differentiator and the fact that we're the only one out there that does business with the unbanked customer, we can add volume to retailers that even if they already have a lease-to-own option, because we have the highest approval rate in the industry when you consider the fact we do – you don't have to have a bank account with us to get approved. So, very strong pipeline.

Kyle Joseph
Analyst, Jefferies LLC

Q

Got it. Appreciate that. And then one last one for me, probably applies a bit to both the Rent-A-Center Business and Preferred Lease. But just in terms of the early buyout activity, can you give us a sense of the cadence of that in the quarter, was it heaviest in April and did it kind of wind down towards the end of the quarter, or did it remain elevated throughout the quarter?

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

A

Yeah. I mean, it was probably – I don't know if you're looking at on month-by-month basis, so starting in April, because the stimulus started in the middle of the month right, the first – the big first deposit was April 15, the irony of the stimulus being on Tax Day is probably why I remember the date, but the April 15 – or at least what used to be Tax Day I should say, but April 15. So – but yeah, they were stronger at the beginning of the stimulus than at the end. The good news for us, if you think about – if you want to think about impact of the stimulus, if you think about the Rent-A-Center Business, with a portfolio coming into the quarter, somewhere in the 3% range, ahead of the year before, and then run about 8% same-store sales.

But the end of quarter, that segment ended the quarter 4% ahead in the portfolio. So, if you think about the stimulus impact, normally in the first quarter when we have except more EPOs from tax returns, the portfolio goes down. And in this case, the portfolio gain year-over-year actually went up. So, the demand certainly offset it from a portable standpoint, more than offset it from a portfolio standpoint plus the actual revenue from the EPO, so it's a great combination.

And then on the Preferred Lease side, as Maureen mentioned, that portfolio ended up 15% year-over-year as well. So, the payouts brought in extra revenue, but didn't hurt the recurring revenue going forward, because obviously that particular payout [indiscernible] (00:38:38) but the demand offset it and our portfolio was bigger at the year-over-year remaining at the end.

Kyle Joseph
Analyst, Jefferies LLC

Q

Understood. Appreciate that. Thanks very much for 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: [Operator Instructions] Your next question comes from Brad Thomas from KeyBanc Capital Markets.

Bradley Thomas
Analyst, KeyBanc Capital Markets, Inc.

Q

Hi. Good morning, Mitch. Good morning, Maureen. Couple of questions for you, if I could. First, I want to just ask about, thinking about the guidance. As you weigh some of the more important factors behind the second half of year here, what do you think is most important as we consider perhaps the low end of the range versus the high end of the range?

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

A

Well, I think executing our basic program is always important from a sales standpoint, collection standpoint, growth standpoint on the Preferred Lease side with more and more demand for the lease-to-own transaction and the retail partners. I think Maureen mentioned it that there's no stimulus figured into our guidance and additional stimulus, of course, it depends what treatment takes. But additional stimulus, probably takes us closer to the higher end of the guidance and I don't know – I mean, honestly, I don't know what would take us to the long run quite honestly.

As you can imagine, when people give guidance, it's a range, because normally you're in the middle there somewhere. But yeah, I think there's upside with another stimulus. And I don't – I mean, downside would have to be where we didn't execute. And I certainly don't see that. The team has executed so well, because even we get asked the question all the time, well, if there's another shutdown, look at the losses and you could say, look at the losses in Preferred Lease and second quarter if that happens again.

Certainly, I don't think anybody expects that kind of shutdown, because we saw what happened to the country, when we did that before. But in the worst case scenario, even up there, we've already made that switch on the staff locations to the contact center. So, we wouldn't have that same kind of blip from a loss standpoint that I was describing earlier.

So, quite honestly, Brad, I don't know anything that would get us to the downside. It's a range for a reason, because obviously, we don't know everything and there's still a lot of uncertainty out there, but I think there's upside if there's in those stimulus, is the best way to answer the question.

Bradley Thomas
Analyst, KeyBanc Capital Markets, Inc.

Q

That's helpful color, Mitch. I appreciate it. And then a topic of great interest in the industry right now is, when are your competitors deciding to split its store and direct businesses? I was hoping, you could maybe talk to how you think about the synergies that come from owning those businesses versus perhaps the potential longer-term to split them up? Thanks.

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

A

Yeah. Thanks, Brad. As you know, we're in the earlier phases of our growth in the virtual retail partner business, right. And we expected to add significant long-term value. So, at this point, we're in that earlier phase of growth, as compared to the company, you're referring to that splitting there. Now, when it becomes a larger part of our business, because there could be an option for us down the road, certainly could be.

But right now, Preferred Lease is benefiting from the high cash flow of Rent-A-Center and that make sure, we have the ample of capital for all of our growth initiatives by keeping them together. But down the road, like I said, when we're past that growth curve and that's a bigger part of our business than the brick-and-mortar, maybe – well, we will see how it works for the other companies, see how the valuation changes over time and that are the ones form our decision down the road too. So, we certainly wouldn't say that we'll never do that. It's certainly not the right time for us, but it's a possibility down the road. We'll see how it works for the other company.

Bradley Thomas
Analyst, KeyBanc Capital Markets, Inc.

Q

That's really helpful. Thank you so much, Mitch.

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

A

Thanks, Brad.

Operator: Your next question comes from Tim Vierengel from Northcoast Research.

Tim Vierengel
Analyst, Northcoast Research Partners LLC

Q

Good morning, and thank you for taking my question. It sounds like everything – a lot of really good news on the demand side of things. We've heard some commentary from both manufacturers and other retailers and appliances and furniture that there have been some supply chain disruptions and those are expected to continue over the next six months to a year. I was wondering if you guys could comment on any disruptions? You guys might be seeing and how you're handling that, or if you're not seeing anything at all? Thank you.

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

A

Thanks, Tim and good morning. So, we've had certainly a little bit. It's gotten better for us. I don't see it as a six months to one year issue. I think it's getting better already and one thing I'd point you to, Tim is, in the press release, the balance sheet or the held for rent numbers, that I don't know how much that people pay much attention to the held for rent or the on rent balance sheet numbers, but what'll see in there is the held for rent, in other words, our inventory levels that are in the stores. The idle inventory levels are down about 20% year-over-year, which is certainly not catastrophic to our rental.

It's like $107 million – Maureen just gave me the numbers now, because I don't have them in front of me, $107 million, down to $85 million year-over-year. So, about 20% which is – it means we have less inventory, but 20% for a retailer doesn't mean you're turning the business. So, we got enough of a buffer there. And we want to get that 20% back up and I see it happening over the next 90 days, not six months to a year from our supply chain people we talk to and our suppliers.

So, it's down a little bit. We wish we had that 20% back in the stores, but now like it's down 50% or 60% [indiscernible] (00:45:25) back up, we're seeing in the last couple of weeks that climbed back up. So, I think it was a pretty minor blip for us and we don't see it as an issue going forward.

Tim Vierengel
Analyst, Northcoast Research Partners LLC

Q

All right. Thank you.

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

A

Thanks, Tim.

Operator: And that concludes our call. I will now turn it back over to Mitch Fadel for final comments.

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

Thank you, Michael and thank you, everyone for joining us today. We appreciate your support and also I want to thank our co-workers out there, they've done such a tremendous job, serving our customers and doing it safely. I thank our franchise partners and our retail partners. And we couldn't be putting these strong results together without all of you. And, again, special thanks to all of you and thanks to those of you who are in this call who joined us this morning. We appreciate your support and we look forward to continuing on delivering these strong results for you. Thank you.

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