Rent-A-Center(Q4 2022 Earnings)

February 23, 2023

Corporate Speakers:

- Brendan Metrano; Upbound Group, Inc.; VP of IR
- Mitchell Fadel; Upbound Group, Inc.; CEO & Director
- Fahmi Karam; Upbound Group, Inc.; Executive VP & CFO

Participants:

- Bobby Griffin; Raymond James; Director, Equity Research
- Jason Haas; BofA Securities; Research Division, VP
- Vincent Caintic; Stephens Inc.; Research Division, MD & Equity Research Analyst
- Bradley Thomas; KeyBanc Capital Markets Inc.; Research Division, Director & Equity Research Analyst
- Anthony Chukumba; Loop Capital Markets LLC; Research Division, MD
- Alex Fuhrman; Craig-Hallum Capital Group LLC; Research Division, Senior Research Analyst

PRESENTATION

Operator^ Good day, and thank you for standing by. Welcome to the Upbound Group formerly Rent-A-Center's Fourth Quarter 2022 Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. I would now like to hand the conference over to your speaker today, Brendan Metrano, Vice President of Investor Relations.

Brendan Metrano^ Good morning, and thank you all for joining us to discuss the company's performance for the fourth quarter and full year of 2022, the outlook for 2023 and our new parent company name an enterprise brand, Upbound Group, Inc.

We issued two press releases this morning before the market opened. The first regarding Upbound and the second, our fourth quarter earnings release. Both press releases and all related materials, including a link to the live webcast, are available on our website at investor.rentacenter.com.

On the call today from Upbound Group, formerly Rent-A-Center, we have Mitch Fadel, our CEO; and Fahmi Karam, our CFO. As a reminder, some of the statements provided on this call are forward-looking and are subject to factors that could cause actual results to differ materially from our expectations. These factors are described in our earnings release as well as in the company's SEC filings. Upbound Group undertakes no obligation to publicly update or revise any forward-looking statements, except as required by law.

This call will also include references to non-GAAP financial measures. Please refer to our fourth quarter and full year earnings release, which can be found on our website for a description of the non-GAAP financial measures and the reconciliations to the most comparable GAAP financial measures. With that, I will turn the call over to Mitch.

Mitchell Fadel^ Thank you, Brendan, and good morning to everyone on the call today. We will start with a discussion of our corporate name change to Upbound Group, Inc., which we announced in our press release this morning.

Then I'll review some full year 2022 highlights and plans for 2023 before handing off to our Chief Financial Officer, Fahmi Karam, for a more detailed review of financial results and our financial outlook. At the conclusion, of course, we'll take some questions.

As I just mentioned, today, the company announced the corporate name changed to Upbound Group, Inc. This is an important milestone for us essentially marking the next stage in the company's journey.

Since acquiring Acima Holdings in February of 2021, which almost doubled the company's size and expanded its presence in point-of-sale financial solutions, we made a lot of progress on integration and strategy development. Today, the 2 organizations have really come together to become a new and exciting company positioned to continue to evolve and grow our reach.

We now think it's important to define who we are under a unifying identity and mission. That identity is Upbound, and its mission is to elevate financial opportunity for all. As Upbound, we will achieve this mission with an omnichannel platform that offers a range of inclusive and flexible financial solutions that can address the changing needs and aspirations of consumers.

Upbound as an enterprise brand that will help to define strategies and unify resources and capabilities across the company so that we can more effectively achieve our objectives. Our customer-facing businesses will continue to operate under the same well-established brands that have built a loyal following over many years.

Upbound represents our transition to a different enterprise operating structure that will enhance strategic planning and other functions within the organization that can be leveraged better as shared services. Upbound should also provide the company with a greater ability to focus on innovating and applying technology to enhance existing solutions and develop new solutions, they will benefit customers and merchants such as targeted credit and point-of-sale loan products.

On Slide 4, we provide a high-level example of the Upbound operating structure. Upbound's an umbrella holding company that's responsible for optimizing functions that can be shared across the organization to drive better performance and efficiency for the operating business units.

Note that we show just a few types of shared services as an illustration, but there are certainly other opportunities for us to realize efficiencies. Another noteworthy aspect of Upbound illustrated in this chart is the potential opportunity to apply our data and analytics capabilities to the vast amount of payment history we have and millions of relationships with our own customers to offer them a broader set of financial solutions, and we hope to have more to share on this front over the course of the year.

Looking at Slide 5, we feel confident that we have the right leadership team to successfully execute Upbound's growth strategy and overall mission. Business unit leaders have deep industry experience with several years of both Rent-A-Center and at Acima.

The shared service leaders are all accomplished in their functional roles with a range of relevant industry experience that includes specialty finance, technology, enterprise sales and account management.

We have a good mix of tenure, roughly half of our leaders have been with us for more than a decade and have deep company and industry knowledge. The other half have joined us in the last couple of years and bring fresh ideas and insights from outside the company.

Additionally, we have several updates within the company and leadership. I'm really excited to announce that Tyler Montrone has been appointed Executive Vice President at Acima and Tyler will oversee the business segment reporting directly to me. Tyler has played a significant role in Acima's development over the years, including senior legal compliance and development roles and most recently has been responsible for Acima's product, engineering and underwriting functions.

I'm also pleased to say, Acima's Founder, Aaron Allred, will continue to work with the company in an advisory role. I'm also pleased to announce that Sudeep Gautam has joined the company as Chief Technology and Digital Officer. Sudeep has an impressive track record of leading digital transformations with companies like Pratt & Whitney and Hewlett Packard. And we believe Sudeep's technology expertise and leadership will be an important factor in our digital evolution.

Also, as we've previously announced, our CFO, Fahmi Karam; and our Head of Business Development, Mike Bagull joined the company within the past 6 months. I will have more to say on Upbound and our plans for the future in the coming months, including an Investor Day on May 24 in New York City. In the interim, to learn more about our vision and mission as Upbound visit our updated Corporate and Investor Relations websites.

So moving on to our fourth quarter results. We're encouraged by the progress we saw in our business, executing well on top line and customer payment objectives and delivering financial results that were better than our fourth quarter outlook, including revenue of $990 million, adjusted EBITDA of $110 million and adjusted EPS of $0.86.

Looking at full year 2022 performance, it's important to consider how disproportionately macro conditions impacted less affluent households. Many of them effectively went through their own recession faced with declining cash balances and rampant inflation. This, combined with the effect of demand pull forward in the previous 2 years, was a significant headwind for our business.

Portfolio values for both Rent-A-Center and Acima were under pressure throughout the year, translating to an 11% pro forma year-over-year decrease in consolidated revenues to $4.25 billion with Rent-A-Center down 4% and Acima down about 16% on a pro forma basis.

Customer payment behavior was also under pressure, which resulted in higher loss rates and lower lease renewal rates compared to the prior year. Skip/stolen loss rates for Acima increased 100 basis points year-over-year to 10.6% and for Rent-A-Center increased 180 basis points to 4.9%, both above our long-term expectations.

Although we took steps to control costs and improve efficiency, the combined effect of lower revenues and higher losses drove over 300 basis points of adjusted EBITDA margin contraction and led to a full year 2022 adjusted earnings per share of $3.70 and compared to $5.57 for 2021. Now despite those headwinds, free cash flow of $407 million was still quite strong, benefiting from running off higher portfolio balances from the beginning of the year.

Now on a positive note, the pressure on our businesses reveal insights and prompted actions that have positioned us well moving forward. We gained a better understanding of sustainable fundamentals when fiscal and monetary excess of the past few years started getting pulled out of the economy. It reinforced the importance of data analytics, risk management, automation and appropriately balancing underwriting discipline with growth. The company has also become a nimbler organization after adapting to the dynamic conditions from last year.

Lastly, it reconfirmed the importance of embracing and investing in technology and adopting a technology-centric operating philosophy to improve the customer experience and to differentiate ourselves with our merchant partners.

And digging into our key operating segments on Page 7. Rent-A-Center revenues and lease demand held up relatively well considering the external backdrop, which speaks to its stability and value proposition to customers.

Revenues were down 4.3% for the full year, in line with our original expectations, but that was down compared to peak stimulus levels from 2021. On a more normal historical basis, 2022 revenues remain healthy with 2-year stack growth of 5.7% and first store revenue still 20% above 2019 levels. Similarly, same-store sales were down 20.5% year-over-year, but 2-year stack growth was 10.8%.

We continue to make progress -- good progress with the RAC digital platform. E-commerce revenues increased mid-single digits for the year, representing approximately 25% of total lease on store revenues compared to approximately 24% for 2021 and just 13% in 2019.

Overall, the pressure on revenues was primarily attributable to a year-over-year decrease in the portfolio with the portfolio finishing 2022 down about 5%. But on a more normalized basis, the portfolio was up approximately 15% from the end of 2019 after adjusting for franchise source, it translates to around a 5% CAGR.

Looking at lease portfolio components, deliveries were down low single digits compared to peak levels in 2021. We launched and advanced several initiatives that help attract and retain customers, including reducing friction in online checkout, launching a retention engine to better match payments with budgets and expanding access to new products and brands through our extended aisle service.

Returns and charge-offs are where the macro environment most negatively impacted the portfolio with renewal rates down year-over-year, loss rates up 180 basis points to 4.9% for 2022. Now the 2022 loss rate increased to 5.8% for the second half of the year above our expectations.

We reacted swiftly in the third quarter with enhancements to account management and adjustments to underwriting to mitigate any further increases in past due rates, which are an early indicator of loss rates stabilized in the third quarter and started to decrease in the fourth quarter. And based on changes we've implemented, we expect to see rates improve gradually throughout 2023.

Now moving on to Acima, you may recall that the business experienced high delinquencies and loss rates in late 2021 after the pandemic stimulus programs wind down. In early 2022, we made changes in leadership and reprioritize strategic initiatives to focus on more conservative underwriting, marketplace execution and profitability.

During the first half of the year, we made numerous underwriting adjustments that reduced loss rates by 370 basis points from the first to the fourth quarter, contributing to a 10.2 percentage point increase in adjusted EBITDA margin. Importantly, this process has enhanced our underwriting and risk management capabilities, which should benefit the business moving forward.

GMV decreased 23% for the full year 2022 on a pro forma basis due to a combination of lower customer traffic and merchant partner retail locations and our own tighter underwriting. We believe we're holding share of volume in stores across our merchant portfolio based on merchant feedback and retail industry data.

Average active merchant locations for the full year increased 13.8% compared to 2021, and we made progress with strategic accounts adding several strong regional merchants, including CITY Furniture and Sleep Outfitters.

Our newly formed enterprise account team has elevated our capabilities, and I'm increasingly confident that we should have additional positive developments in 2023.

Moving on to our outlook. 2023 looks like another year of macro uncertainty with the consensus view of economists projecting that recession will begin sometime this year. Historically, the Rent-A-Center businesses outperformed during recessions while Acima has yet to really be tested in a down cycle.

We believe a big part of that outperformance is nontraditional LTO customers dropping into the LTO market when unfavorable circumstances arise like job loss or consumer credit tightens. We did not see significant indications of trade down in 2022 as inflow was strong and credit was ample.

Based on recent trends, there is a better chance we'll see at least some trade down in 2023, but we've not included it in our base case forecast given how different this economic cycle has been compared to previous cycles.

Given the macro backdrop, high-level operating priorities for 2023 are similar to 2022, maintain underwriting discipline and look for good risk-adjusted opportunities to add revenues and continue to control costs to support margins and cash flow. With underwriting now well aligned with external conditions, strategic initiatives should give more focus in 2023, including Upbound-related initiatives that we believe will return us to growth in 2024 and beyond.

We're also in the early stages of exploring opportunities to leverage our expertise in the underserved consumer market and specifically, our existing customer database to offer additional financial solutions that can broaden customer options and eventually expand our market reach. And as I mentioned earlier, there would be more to come on this as we progress into the year.

Top priorities for the Rent-A-center business are to grow and retain the customer base. We'll do this by expanding our products and brands through our extended aisle offering, improving customer experience and engagement among numerous fronts. We plan to invest in technology to enhance the digital and omnichannel journey for consumers. And on top of those priorities, getting loss rates back towards 4% is also our priority.

Top priorities for Acima include growing the merchant base, both the SMB channel and enterprise, continuing to optimize underwriting and enhancing our technology capabilities. This includes recovery and account management improvements, leveraging the expertise of our Rent-A-Center business. And we'll also continue to assess ramping up our direct-to-consumer solutions and other solutions as market conditions are supportive.

As we start this next stage of the company's journey as Upbound, I believe we're very well positioned to play an important role in the evolving market for more inclusive and flexible consumer financial solutions. In doing so, I believe we can achieve compelling growth and deliver significant value for our customers, merchant partners, employees and shareholders.

And I want to thank the entire team for their continued effort and dedication. I've been really impressed with the progress we made over the last year, and I see tremendous opportunity in our future. And with that, I'll turn the call over to Fahmi.

Fahmi Karam^ Thank you, Mitch, and good morning, everyone. I'll start today with a review of the fourth quarter and full year financial performance and then quarterly guidance, after which we will take questions.

I'll start my commentary on Page 9 of the presentation and would like to note that we added a new key metric table in the press release this quarter to help investors more efficiently assess the company's performance.

We've also disclosed a couple of new metrics at the segment level that we've highlighted in the past that will disclose more prominently going forward. For Rent-A-Center, that's our portfolio value and for Acima, it's GMV.

Moving on to the results. Consolidated revenue for the fourth quarter was down 15.4%, led by a 22.2% decrease for Acima and a 7.7% decrease for the Rent-A-Center business.

Looking at revenue categories, rental and fees revenues were 13.3% lower and accounted for most of the decrease in consolidated revenues, reflecting lower portfolio values for both businesses during the current year. Merchandise sales revenues decreased 26.8% as a result of fewer customers electing early payout options.

Consolidated gross margin was 50% in the fourth quarter, up 190 basis points year-over-year due to a higher mix of rental and fees revenues compared to merchandise sales in the current year period.

We continue to execute well on expense management in the fourth quarter with consolidated costs, excluding skip/stolen losses, down 8% year-over-year, led by a 10.4% decrease in labor costs.

As Mitch noted, our efforts in account management and underwriting are paying off, evidenced by our fourth quarter loss rate of 8.9% for Acima, which was down 290 basis points year-over-year and is the lowest since 8.7% in the third quarter of 2021.

The Rent-A-Center loss rate was 5.8%, in line with our expectations, but above our long-term target levels. We have seen continued improvement in past due rates, which suggests loss rates should continue to trend lower as portfolio turns with newly created leases.

Fourth quarter consolidated adjusted EBITDA of $110 million was down 15.2% year-over-year with a 30.1% decrease at Rent-A-Center, offsetting 22.4% growth for Acima. Adjusted EBITDA margin of 11.1% was flat compared to the prior year period, with 470 basis points of margin contraction for Rent-A-Center, offsetting 540 basis points of expansion for Acima.

I will provide more detail on the segment results on the next few slides. Looking below the line, fourth quarter net interest expense was $26.4 million compared to $18.6 million in the prior year due to an approximately 400 basis points year-over-year increase in variable benchmark rates that affected $950 million or 70% of our total debt. The higher interest expense alone was a $0.10 EPS headwind compared to the prior year period.

The effective tax rate on a non-GAAP basis was 25.8% compared to 23.4% in the prior year. The non-GAAP diluted average share count was $56.5 million in the quarter compared to $65 million in the prior year period.

GAAP earnings per share was $0.05 in the fourth quarter compared to $0.15 in the prior year period. After adjusting for special items that we believe do not reflect the underlying performance of our business, non-GAAP diluted EPS was $0.86 in the fourth quarter of 2022 compared to $1.08 in the prior year period.

During the fourth quarter, we generated $44.4 million of free cash flow compared to $49.5 million in the prior year period. We paid a quarterly dividend of $0.34 per share. And during October, which we previously disclosed in the third quarter call, we repurchased 2.3 million shares at approximately $19.50 per share. No additional share repurchases were executed in November and December.

Drilling down to segment results on Page 10. The Rent-A-Center business lease portfolio value was down 4.7% year-over-year, which drove a 6.8% decrease in the fourth quarter, rental and fees revenue and contributed to a 20.5% decrease in merchandise sales revenue. Merchandise sales were impacted by fewer customers electing early payout options compared to the prior year period.

Total segment revenues decreased 7.7% year-over-year with same-store sales down 8.1%. Considering the strong prior year growth, it's worth noting that both total revenues and same-store sales were up low single digits on a 2-year back basis.

The trend of lower same-store sales and revenue in the mid-single digits has continued in the first part of 2023 as tax season has not begun in full effect and consumers remain cautious.

Skip/stolen losses increased 180 basis points year-over-year to 5.8%, which was in line with our quarterly expectations. We believe the higher loss rate was primarily due to greater pressure on customers' budgets as inflation accelerated and remain elevated throughout the year.

We made changes to tighten underwriting standards in certain segments and account management starting in the third quarter. Past due rates have moved lower and a downward trend suggests that loss rates should improve over the next few quarters as newer monthly vintages become a larger percentage of the overall portfolio.

We've continued to see this positive trend in the first few weeks of 2023 and are encouraged by our ability to manage losses while maintaining the portfolio.

Adjusted EBITDA margin for the fourth quarter decreased 470 basis points year-over-year to 14.6%, primarily due to the lower revenues and higher loss rates compared to the prior year period. Those headwinds were partially offset by lower labor, advertising and other operating expenses.

Moving to Acima. During the fourth quarter, GMV decreased 23.4% year-over-year, primarily due to macroeconomic pressure on consumers and the pull-forward effect of stimulus that caused a drop in application volumes for merchant partners. This trend had also continued in the first few weeks of 2023. Offsetting lower traffic, merchant locations in the fourth quarter were up mid-single digits compared to the prior year period.

With GMV running down over 20% in the past few quarters, our open lease count was down in the high teens compared to the prior year period. This drove a 22.2% year-over-year decrease in revenues, with rental revenues down 20.2% and merchandise sales revenues down 28.6%.

Skip/stolen losses decreased 290 basis points year-over-year to 8.9%, which was slightly better than our outlook. Underwriting changes made in the first half of the year and our continuous monitoring of higher risk segments has continued to benefit losses since the highs seen earlier in 2022.

Also worth noting that our virtual business, excluding legacy staffed business, loss rates for the quarter were 8%, at the high end, but within our 6% to 8% expectation for that part of the business.

Adjusted EBITDA of $71.7 million was up 22.4% year-over-year, driven by lower losses and operating costs, offset by lower revenue. Adjusted EBITDA margin of 15% increased 540 basis points year-over-year and 240 basis points sequentially.

On a full year basis, consolidated revenue decreased 7.4% on a reported basis and 11.2% on a pro forma basis, reflecting the February 2021 acquisition of Acima. The decrease in reported revenue was evenly split between rental and fees revenue and merchandise sales revenue as both were down approximately $150 million from 2021.

Consolidated gross margin was 48.9%, up 40 basis points year-over-year due to a higher mix of rental and fees revenue compared to merchandise sales in the current year period.

Adjusted EBITDA of $453.5 million decreased 28.2% year-over-year on a reported basis and 32% on a pro forma basis. The Rent-A-Center business accounted for approximately 2/3 of the decrease and Acima accounted for approximately 1/3. The primary factors that drove EBITDA lower were the decrease in revenues and higher loss rates.

Operating costs, excluding losses decreased 1% year-over-year on a pro forma basis with labor costs down almost 2% and G&A down 4%, reflecting our cost management efforts.

Full year net interest expense was $87.1 million compared to $70.7 million in the prior year due to higher variable benchmark rates. The higher interest expense was a $0.21 EPS headwind compared to the prior year period. The effective tax rate on a non-GAAP basis was 25.8% compared to 23.3% in the prior year. The non-GAAP diluted average share count was $59 million for the year compared to $66.8 million for 2021.

For the year ended December 31, 2022, we generated $468.5 million of cash flow from operations and $407.1 million of free cash flow, up from $392.3 million of cash flow from operations and $329.9 million of free cash flow in 2021.

We paid an annual dividend of $1.36 per share and repurchased $3.5 million shares at approximately $21 per share. The company has approximately $285 million remaining on its current share repurchase authorization. In addition, at year-end, we had a cash balance of $144 million, gross debt of $1.4 billion, net leverage of 2.8x and available liquidity of approximately $540 million.

Shifting to the 2023 financial outlook. Note that references to growth or decreases generally refer to year-over-year changes unless otherwise stated. For the full year, we expect to generate revenue of $3.8 billion to $4 billion, adjusted EBITDA of $380 million to $415 million, which excludes stock-based compensation of approximately $24 million. We are projecting modest margin contraction as lower revenues will largely be offset by lower losses and operating expenses.

Fully diluted adjusted earnings per share is expected to be $2.50 to $3, which assumes a fully diluted average share count of $56.7 million with no share repurchases throughout the year. For the year, we expect $180 million to $215 million of free cash flow. Net interest expense of $105 million to $110 million and an effective tax rate of 25.5% to 26.5%.

Our forecast assumes a macroeconomic backdrop consistent with existing conditions, persistent inflation and a slight increase in unemployment.

For Acima, full year 2023 GMV is expected to be down low to mid-single digits year-over-year as we expect merchant partner volumes will remain under pressure from the prevailing macroeconomic conditions and the remaining impact of the pull forward.

GMV will start off the year with similar year-over-year trends that we experienced in the fourth quarter, but we do expect that to improve throughout 2023 and get back to year-over-year growth by the third and fourth quarter as some of the headwinds for merchant volume applications improve and targeted sales initiatives take effect.

We expect Acima full year revenues will be down low double digits with the first half of the year down in the high teens in the second half down mid-single digits. Adjusted EBITDA margin is expected to be in the low double-digit range and remain relatively consistent throughout the year as loss rates should stay around 9% to 9.5% range.

For the Rent-A-Center business segment, we expect 2023 revenues and same-store sales to be down in the low to mid-single-digit range, mainly driven by a lower lease portfolio due to lower demand and higher return rates. Adjusted EBITDA margin is expected to be in the mid-teens range throughout the year with loss rates improving throughout 2023, with continued elevated losses in the first quarter and ending the year in the 4.5% range.

We expect the Mexico and Franchising businesses will generate similar results to 2022. Corporate costs are expected to increase mid- to high single digits, reflecting several new executive leadership additions in late 2022 and early 2023 as well as lower-than-normal performance-based compensation in 2022 and higher technology investments across the organization.

For the first quarter, total consolidated revenue will be down in the mid-teens year-over-year, with adjusted EBITDA margins in the 9.5% to 10% range. Interest expense, tax rate and share count should be similar to the fourth quarter of 2022.

Regarding capital allocation, the top priorities continue to be dividend payments and debt reduction. Given the pressure on the portfolio size and revenues, paying down debt to maintain a relatively flat leverage ratio is a top priority. Over the long term, we continue to target a 1.5x debt-to-EBITDA ratio.

Touching quickly on the Corporate name change. As Mitch mentioned earlier, the changed to Upbound Group became effective yesterday. Starting on Monday, February 27, our shares will be listed on NASDAQ under a new ticker, UPBD.

In summary, 2022 was a challenging year for our customers as well as our financial results. We have demonstrated our ability to identify risk in our portfolio in both segments, adjusting our underwriting and account management practices, and we've seen the impact of those adjustments with lower delinquencies and losses throughout the year.

We have a strong balance sheet and generate strong cash flows. We have an opportunity to further support our core businesses with a unified strategic direction, leveraging best practices and realizing operational and cross-brand synergies.

The macro environment will remain uncertain in 2023, especially for our consumers. However, we believe we have a resilient business with a disciplined approach that can deliver long-term sustainable growth. Thank you for your time this morning. We will now turn the call over for your questions.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) Our first question comes from the line of Bobby Griffin with Raymond James.

Bobby Griffin^ I want to follow up first on the Acima comments around 1Q. I think I heard you correctly, it's GMV down similar to the 4Q trends, so call it, I guess, low 20s. The comparison starts to get easier, though in 1Q. So just curious why we shouldn't see some type of maybe sequential recovery, I mean at least still down, but less down, given that we're starting to lap minus 20% GMV growth throughout 2022?

Fahmi Karam^ Bob, thanks for the question. This is Fahmi. Yes, the comment was really there's going to be similar trends to the fourth quarter. I don't expect it to be in the low or mid-20s. So it will be down year-over-year. But you're right. We started making some changes in underwriting in the first part of the first quarter of 2022. It didn't take full effect at the beginning of the quarter, but it will be down, I'll call it, mid-teens in the first quarter year-over-year despite some of the changes that we made last year.

Mitchell Fadel^ Yes. So you have some -- Mitch here. You have some of those -- the comps start to change. So it will be down less, but still be down, I think, was the point of the comment. And then as Fahmi mentioned also in his prepared comments as we go through the year, third and fourth quarters when we would see it being back in a positive territory. So it's kind of like a -- yes, it gets better a little bit each quarter along the way, the negative mid-teens that we set in the first quarter and then by third and fourth quarter, we're in a positive territory.

Bobby Griffin^ And I guess, secondly, Mitch, on the sourcing of products, have you started to see some break in the cost? Because I kind of have a view that inflation basically priced out this consumer, your target consumer base, even if they needed some of these durable products, just given that you had a pass through the massive level of inflation we've seen across all kind of durable products.

Are you starting to see breaks in sourcing where you can lower kind of the rental prices to customers? And is that starting to move demand in certain categories where that actually happened?

Mitchell Fadel^ Yes. I think absolutely, it has. We're back to -- of course, they went up a lot. We're back to deflationary times when it comes to electronics. Electronics have been deflationary for so many years. So they come out with some newest starts deflating from day 1. Of course, that changed for a couple of years during the pandemic, but we're back to things dropping down now in electronics.

Really, all categories have had to drop some more severe than others. We've even seen some furniture pricing reductions, quite honestly, not so much in appliances yet, but electronics and furniture, for sure. So yes, I think we're seeing some of that deflation that will help our business in 2023.

Bobby Griffin^ And then, I guess, lastly for me, just on the leverage side of things. I understand kind of what the game plan is for 2023. But on a multiyear basis, should we think about share repurchases turned off until we get closer to the target? Or would you still look at it even if you're above target if you know there's excess cash or just any kind of decision like that?

Mitchell Fadel^ Yes. I wouldn't say they are turned off. They're going to be opportunistic in nature. We're very focused on, as I mentioned, maintaining our leverage ratio to kind of flat to slightly up this year given the pressure on EBITDA. We paid over $200 million of debt in 2022. And I don't think we'll be able to get to that level in 2023, just given the drop in free cash flow year-over-year. But our focus is to maintain that leverage ratio around where we ended the year. So paying down that debt is still a top priority.

Operator^ Our next question comes from the line of Jason Haas with Bank of America.

Jason Haas^ Just wanted to follow up on that, on the Acima GMV. What gives you the confidence that you will see an acceleration and get back to positive by the second half of the year? Because I don't think the compare is at least on a 1-year basis. I don't think they eased that much through the year. I'm not sure if you're looking on like a multiyear basis, if that's the case, or if there's anything else that we should just be aware of to get some confidence that we will see that acceleration?

Mitchell Fadel^ Yes. I think because of the comps we're going over and even though you're right, 2022 was pretty flat. But when you look at multiple years, of course, 2022 had different times of the year, we're tightening the underwriting so that kind of flattened things out. But in other years, you'll see the fourth quarter certainly trend up from a seasonality standpoint. So we put multiple years in there, Jason. We see -- we trend it conservatively still trend our GMV, but we could do it based on multiple years.

The way the comps come out, you end up with some positive and they're not going to be huge positive numbers in the third and fourth quarter, but we'll be low to mid-single digits is what we believe.

Jason Haas^ And then as a follow-up, I was curious, Mitch, if you could talk about -- it sounds like you're not really seeing much benefit from credit tightening yet. I'm curious when you expect that might happen? And when we do see that, do you think it will benefit the Acima segment more or the Rent-A-Center segment more?

Mitchell Fadel^ Yes, good question. We've seen a little of it. And I think we said in the comments that we -- in recent trends, it just hasn't been significant yet, certainly not like past cycles downturns where it was almost immediate. But because the unemployment rate and it's remaining so strong, we haven't seen much.

We've seen a little bit depends on the retail partner. When we look at some of our larger ones, it depends on how the retail partner is willing or not willing to pay fees to the lenders above us to -- because they'll have to pay more merchant fees as interest rates goes up and things like that. So -- but we are seeing a little, certainly, nothing large yet.

Our Vintage scores coming in, like especially the top 10% of our scores are showing a little bit of an increase. Like at Acima, we haven't loosened underwriting at all and our approval rates are up a point or 2, which means a little different customers coming in. So we're seeing a little. We don't have any of it in our forecast for this year. So that's all upside for us in 2023.

And the second part of your question, yes, I think Acima will see it more noticeably, presuming it does get to a significant level in 2023. Just because -- I mean, Rent-A-Center is pretty consistent anyhow. They just don't have the volatility in their portfolio that Acima does. And it's not directly aligned with lenders above us. It's not like a waterfall business when people go in to rent a center. So yes, I think Acima would see more of it than Rent-A-Center.

Jason Haas^ And if I could squeeze one more question. I was curious if you look by category, if there's anything performing noticeably better or worse than others by like furniture and mattresses versus consumer electronics and other categories, I guess, both in Rent-A-Center and the Acima business?

Mitchell Fadel^ Yes. I think the items -- I think, Jason, it comes down to the items, the big pull forward in '20 and '21 was really in the furniture space. Other things not as much, certainly laptop, computers were pull forward as people start working from home. But other things, there wasn't really a pull forward in appliances, people then just replace their appliances because they are home more. That's more of a replace whey they break, at least for our customer.

So the real pull forward was in furniture. You look at some other categories where Acima's bigger like wheel and tyre where there wasn't a pull forward. And we're not seeing weakness in that compared to furniture. So it's really furniture stands by itself when it comes -- in our business when it comes to a pull-forward comment, furniture really stands alone.

Fahmi Karam^ And our mix at Acima has also shifted, going back to the earlier comment that gives us confidence that we can grow throughout the years is our ability to kind of shift the product categories that we do. So we talked about Acima being down from a GMV standpoint, on 23%. But if you look at jewelry and electronics and auto, as Mitch mentioned, those are only down 5% year-over-year. So the mix shift also helps.

Operator^ Our next question comes from the line of Vincent Caintic with Stephens.

Vincent Caintic^ So nice brand name changed and look forward to the Investor Day. So just maybe wanted to touch on that, if there's any, in addition to the brand name changed, any strategic changes or shifts that you might be seeing as part of that?

Mitchell Fadel^ Sure. Vincent, I think it's a few things. We mentioned the new products that this kind of paves away from a strategic standpoint. And when we say new products, we're talking about loan products, you know some of our competition already has a loan product out there to go along with the lease on product to move up a little bit.

So we're looking at those kind of products as we move up in the credit and loan products at the point of sale. That's certainly part of the strategy. We're in the early stages of looking at that. But again, that's certainly part of the strategy.

The way sharing best practices and a shared service model where -- not like we're adding a whole bunch of people in the shared service model, just moving some deckchairs around and where we can create shared services for both the big segments add a third segment here down the road in the lending products that I mentioned. So -- but it's really that those products, the shared services, the sharing of data that can really make an impact from an underwriting and a marketing standpoint, collections as well, Rent-A-Center helping collect and pick up a lot more on the Acima front.

So it's a matter of -- there's been some -- quite a bit of integration in the last year anyhow, and the companies are really starting to work well together. And we just thought it was the right time for us to do the -- got the holding company route where it's, like I said, shared services, best practices and those kind of things and really feed off each other and be able to set the strategy at the up-bound level, which would be taking advantage of those best practices synergies, certainly some synergies to be gotten as we do this along the way.

Nothing in our model, in our financial forecast, but we think there's some synergies down the road as we look at this. And we're really excited about getting into some new products.

Fahmi Karam^ Yes. Maybe, Vincent, I'll add to that a little bit. We are -- as part of the strategy, we're still in the early stages of evaluating and assessing it, especially around our approach and timing, and we'll be able to update you more on Investor Day. We know it's an opportunity for us.

We have millions of customers that we've dealt with, that we have payment history with, so the ability to kind of monetize our customer database and help them kind of move upward in their financial journey. If you think about who our core customers are, they typically either have bad credit or no credit and are not able to get some of those typical lending products. But for us, we actually have history with them. We have payment history, and we have the data behind it to be able to potentially offer them those types of products.

And then the second piece, as Mitch said, the point of sale. We think our merchant partners, especially on the small, medium-sized businesses will really get a lot of traction with that. It drives incremental sales. And honestly, it makes us stickier with them on the LTO side as well. So definitely feel like it's an opportunity for us. We'll have more for you as we progress through the year.

Vincent Caintic^ And just second, following up on the GMV discussion. I'm just wondering if there's other changes that need to happen for the GMV improvement? Or is it just comps, for example, thinking about your approval rates or on the Acima side, is more merchant engagement needs to happen? Just sort of what are you assuming as GMV improves throughout the year?

Mitchell Fadel^ Yes, good question. We're not assuming any large enterprise accounts, although that's certainly always an opportunity as we've built that team out not as a direct answer to your question, I'll get back to that, but Mike Bagel joined us about 6 months ago is building out that team. We're starting to see much better conversations at that highest level from an enterprise standpoint. So we're excited about where we're going with that.

But in the way Acima has always grown the core business, I mean, we did -- we do have more active merchants now than we had a year ago. So we're growing from that standpoint.

We think we can target from a strategic standpoint. I mentioned Tyler Montrone now in charge to Acima, believes we can target better to get more GMV out of the merchants that are -- the ones that are giving us GMV now like more of a targeted approach than approach, not that we won't be adding a lot of merchants, but just the ones we already have, how do we target more out of certain ones and so forth, and those kind of things.

So it's more of a targeted strategy on the SMB. Of course, the enterprise strategy I mentioned. But I think it's a targeted strategy from a sales standpoint. And we've got momentum from that standpoint also.

It's not like we've lost merchants. So our merchant base, even though we're sitting at minus 20 for GMV in 2022, our merchant base grew. Of course, with all that pull forward in furniture, it's under a lot of pressure to actually grow GMV, but the merchant base is still growing. So that's probably the biggest part of the answer, Vincent, is the merchant base is still growing.

Vincent Caintic^ And just -- is there kind of any change to the approval rates or any assumptions there?

Mitchell Fadel^ No, just more -- I mean, more of the same as far as the customer. We're not assuming that things get better where we'll be able to improve a higher percentage or so point that I mentioned approval rates have ticked up slightly the last couple of months, but that's without changing the underwriting, that's really where we're starting to see probably just at least a little bit of trade down.

But no, we're not assuming that we'll be able to loosen that would be a tailwind. Obviously, a headwind if we had to tighten more. But we're not assuming the customer behavior changes in 2023.

Fahmi Karam^ We've done a lot, Vincent, over the year to really dig into our decision engine, understand our data better as we kind of had really high losses in the first part of the year. We had to look at it at a very granular level, whether it's by product category or by channel or even at the merchant level to really try to optimize our approval rates and our conversion rates.

And so we're going to continuously look to tweak those and try to get as much GMV and penetrate those good merchants as we can. So it's hard to look at just approval rates because the strategy changes across 25,000, 30,000 merchants.

Mitchell Fadel^ Yes. When you look at those past due and lost charts that are in the presentation, I don't know if you've looked at the presentation, Vincent, if it's in front of you or not. But on the Acima side, as bad as those had gotten in late 2021 and early 2022, it's really impressive how fast the team, Aaron Allred, obviously, we had him come back and work on -- Aaron and Tyler basically, how fast -- and a gentleman by the name of Stewart and so like, those 3 guys, the way they brought down those losses and past due numbers as quickly as they did. And now we got loss numbers as well as the third lowest since mid-2021.

So certainly proved we can do it and learned a lot as Fahmi anything on the Rent-A-Center side with that underwriting team, the -- as soon as you look at those past due numbers during the presentation, it jumped in July, and now we're back down already, already back down below July and of course, we got tax season coming.

So we proved -- we learned a lot. We learned a lot. We're better today than before that happened to us in both segments. So that's the brightness of the future.

Operator^ Our next question comes from the line of Brad Thomas with KeyBanc Capital Markets.

Bradley Thomas^ I just want to follow up on, I think, the last topic of the losses, the skip/stolen. Can you talk a little bit more about expectations here for the full year and the ranges that you're targeting for the two larger segments?

Fahmi Karam^ Sure. So obviously, we just talked about Acima's coming down almost 300 basis points year-over-year. So it's kind of back into our range. The virtual side of the business at 8% for the quarter, that's at the high end, but within our range for that business. And so guiding on a combined Acima segment in that 9% to 9.5% range, very similar to where we ended the fourth quarter is where we expect it to be.

And then on the Rent-A-Center side, obviously, the 5.8% in the fourth quarter was higher than what we'd like to see. It's much higher than our target levels but consistent with our forecast. Throughout the year, we expect that to trend down. So first quarter will still be a little bit elevated.

It will be better sequentially, but will still be elevated compared to historical trends and then end the year kind of in that 4.5% range. And if things go well and the macro gets a little bit better, maybe we can drive it a little bit further than 4.5%. But the guidance we gave gets to the 4.5% on the Rent-A-Center side.

Bradley Thomas^ And then maybe, Mitch, I just wanted to ask a question about the Rent-A-Center store business. The segment's coming off of, I think, 3 really good years for revenues and still running at profitability that most retailers would kill to have. But as you face perhaps a tougher revenue outlook going forward, can you talk a little bit about the store portfolio and what you think the right number of stores is and how you might want to invest in and evolve that portfolio going forward?

Mitchell Fadel^ Yes. Good question, Brad. I think we're very comfortable with the store count is today. We think there's some opportunity down the road. We've mentioned in the past calls, we're testing some smaller footprint. We think we can cover the country and cover a lot of our business, as we mentioned, coming from e-com in the 25% range. But the stores are still the fulfillment center for that.

So we're comfortable with the account we have now probably could do it in less square footage on average. So we're testing some of that using technology in the stores to search categories versus having to have as much showroom space and so forth. So we're going to be able to, over the next 5 years, bring down the cost of real estate, I believe. But the store count itself will stay about the same.

We're still running 15% higher than 2019 portfolio levels on a per store basis or even on an overall basis when you back out some of the stores we sold to -- we basically sold California in 2020 to a large franchisee, so.

But 15% growth, we think we're -- we can finish this year at or above where we are now. So it doesn't go lower from here to go lower in the course of the year, but we see -- we really see 2023 as a trough year for Rent-A-Center and for Acima for that matter, although Acima's EBITDA won't be much off 2022s,but a trough year overall, and especially at Rent-A-Center.

So the store count won't change a whole lot. We don't believe going forward, we have some opportunities from an overall square footage standpoint. But I think we're getting as low as we believe it's going to get, again, when you think about year-end numbers.

So it will get lower this coming next few weeks and months with income tax refunds, we lose some portfolio and then build it back, especially as we go into the fourth quarter. But we expect to finish this year from a portfolio standpoint, at least flat with where we started the year and therefore maintain that 15% growth over 2019 levels, pre-pandemic levels.

Bradley Thomas^ We've talked about kind of tax refund season, it's come in a couple of questions. I think the early data would suggest that the average refunds are down kind of double digits from a year ago. Any particular view on how tax season will play out and implications perhaps for your business?

Mitchell Fadel^ Yes. Those -- I don't -- yes, I think you know, Brad I've done this a long time. I don't get too wrapped up in some of those numbers that come out because they're not necessarily related to our consumer. So I don't know that the consumer at the $35,000 to $40,000 income range is having 10% to 12% lower refunds or not. I know that those are the overall numbers. We'll know soon enough. We'll know in the next couple of weeks when it comes to what we're seeing in the business.

So the good news there, Brad, is if there's less money, there will be less payouts. The portfolio actually maintains -- might maintain better than we anticipate. On the other hand, when there's a good income tax season, I mean we've put a lot to business on the books, too.

So it's -- they tend to -- well, the portfolio still goes down. They don't balance up. We don't do enough new business for the portfolio not to go down at all. It does go down during tax season, but the money is good and the payouts, especially on the Rent-A-Center side, we still make good margins on those.

So, if there's a few less payouts, that will be good for the portfolio. So we're not really worried about it, whether it's -- if they're a little lower or not. I don't know that they will be lower, but I don't see how that's going to be much of a negative for us.

It could end up a positive for us if they're a little lower, especially on the Acima side, where we would -- less payouts are really a good thing at Acima because we don't make a heck of a lot on those early payouts unlike Rent-A-Center where we got the difference between wholesale and resale built in there where we're okay when there's those early payouts. So we're not -- whether there's a few less payouts or not, I don't think it's going to matter a whole lot at the end of the day.

Operator^ Our next question comes from the line of Anthony Chukumba with Loop Capital.

Anthony Chukumba^ So I know it's probably a bit difficult to parse out, but as you think about the 23% GMV decline in Acima last year, how much of that was you proactively tightening credit as opposed to sort of the pullback in demand at your retail partners? Because it sounds like, at least from a door's perspective, you guys had a pretty good year. So how do you sort of think about that?

Mitchell Fadel^ Yes, I'll start and Fahmi you can chime in. Yes, we did have a pretty good year from a doors count standpoint, but each location was less productive, especially the furniture locations. Even where there wasn't a pullback like Fahmi was talking about on the auto space or even the jewelry space, where there wasn't much of a pull forward in '20 or '21.

We're still down in the mid- to high single digits just based on -- so that -- if you say that's underwriting, you're somewhere in the half and half range as far as traffic at the retail partner versus underwriting. Maybe it's a little more on the traffic side than it is underwriting. But there's somewhere 50-50 as far as the reasons for it.

Fahmi Karam^ Yes. And I would add to that, it's also average ticket size in our product mix also is part of the GMV calculation. So, average ticket sizes have trended down throughout the year, especially year-over-year.

Mitchell Fadel^ Because of the mix...

Fahmi Karam^ And the mix also has trended down. So, Anthony, it's tough to kind of parse out, as you said. It's a combination of all those 3 things. But if we had to rank it, I do think traffic is probably at the top of the list.

Anthony Chukumba^ And then just one quick follow-up. From a credit underwriting perspective, I mean have you sort of stabilized that? Like are you tightening at all? Are you losing it all? I'm thinking more kind of sequentially?

Mitchell Fadel^ I would say, yes, all of the above, Anthony. We're continuously kind of trying to optimize and drive higher yield, better performance and then ultimately get to a better EBITDA number. So it kind of depends. Your question is have we bottomed out. It depends on your view of the recession. There's a lot of conflicting signals on where we're going.

We feel good that if we see early indications of risk in certain segments, we have the ability now to adjust pretty quickly at a very granular level. So, around losses, the question will become how much GMV do we lose if we have to tighten? So it's more around demand, portfolio size than it is the overall loss rate just given the fact that we've been able to decrease in such a short period of time.

Fahmi Karam^ And I had mentioned, Anthony, that the -- not seeing any significant trade down yet, but we think we're starting to see a little of it. Our approval rates are actually -- have actually gone up but a hair on the Acima side without loosening underwriting, which means there's a little bit different customer at least coming into the mix. So we look at our Vintage scores and they are, I mentioned earlier, at least the top 10% we're seeing differences in the score.

So I think if you see some trade down, then that naturally moves the approval rates up a little bit without -- because of a better customer for us coming into the funnel, a more creditworthy customer, I should say, coming into the funnel. And that can -- that help -- that can help the approval rate even with us not changing underwriting.

Operator^ Our next question comes from the line of Alex Fuhrman with Craig-Hallum.

Alex Fuhrman^ It sounds like furniture and to some extent, laptop computers were really the big driver of demand in 2021 and is now creating some tough comparisons. As you look at this being the trough year, what do you think is going to really be the category that helps to drive demand to lead you out of that trough year? Do you think furniture is likely to reaccelerate? Or do you think it's going to be more weighted towards appliances or other categories as you resume growth?

Mitchell Fadel^ Personally, I think it will be across all the categories. I think every quarter, we get farther away from the pull forward on furniture, it's helpful, same with the laptops that I mentioned. There's -- we have game systems on the Rent-A-Center side now that are helping with some of the new games that came out last year that there wasn't great availability on, but now there is. So electronics will help us.

I think it will be a pretty widespread. I mean, Acima's doing really well in the auto business, wheel and tyre specifically, jewelry, depending on the timing, it's spotty, obviously, Valentine's Day and Christmas and so forth. But I think it will be across all of them, just because I think the furniture category is it -- hit bottom in 2022. So, I think the growth coming out, especially our exit growth velocity at the end of 2023 will be on all categories.

Operator^ That concludes today's question-and-answer session. I'd like to turn the call back to Mitch Fadel, CEO, for closing remarks.

Mitchell Fadel^ Thank you, Liz, and thank you all for joining us today. We appreciate your interest in our company, and we look forward to talking with you more in the future about the exciting developments, the opportunities. Of course, we mentioned in the Investor Day, May 24 in New York City.

And we'll be talking to you before that on an earnings call, but put that on your calendar, and we look forward to updating you on our -- the exciting developments and opportunities we see here at Upbound, formerly known as Rent-A-Center. So have a great day, everyone.

Operator^ This concludes today's conference call. Thank you for participating. You may now disconnect.