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Rent-A-Center, Inc. (RCII)

Q4 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and thank you for holding. Welcome to Rent-A-Center's Fourth Quarter 2018 Earnings Conference Call. As a reminder, this conference is being recorded, Tuesday, February 26, 2019. Your speakers for today are Mr. Mitch Fadel, Chief Executive Officer of Rent-A-Center; Maureen Short, Chief Financial Officer; and Daniel O'Rourke, 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
Vice President-Finance & Real Estate, Rent-A-Center, Inc.

Thank you, Jessa. Good morning, everyone, and thank you for joining us. Our earnings release was distributed after market close yesterday, which outlines our operational and financial results for the fourth quarter of 2018. All related materials, including a link to the live webcast, are available on our website at investor.rentacenter.com.

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

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

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

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Thank you, Daniel, and good morning, everyone. Thank you for joining us. While we will get to our financial and operational performance in a minute, I want to first address the status of litigation following our termination of the merger agreement with the affiliates of Vintage Capital.

On February 11 and 12, the trial was held in the Delaware Court of Chancery in the lawsuit arising from Rent-A-Center's termination of the merger agreement. While it's difficult to predict the outcome of litigation, the company believes, under the express and unambiguous language of the agreement, it had a clear right to terminate the merger agreement, and that is described in our counterclaim the company is entitled to the $126.5 million reverse breakup fee do following the termination of that agreement. Oral argument on the parties' post-trial briefs is scheduled for Monday, March 11. And we do ask that you keep your questions focused on our financial and operational performance when we conclude our presentation. And speaking of our presentation, we'll be providing a voiceover to the presentation shown on the webcast. If you're unable to view the webcast, the presentation can also be found on our Investor Relations website.

When I returned to Rent-A-Center back in January of 2018, we've built a plan focused on three key pillars, and we have made significant progress in each area. First, we needed to optimize or right-size the company's cost structure. Second, there were additional enhancements that value proposition needed to drive customer growth and improve our return on investment. And, finally, the last pillar was to accelerate our refranchising efforts.

I'll go into the key highlights shown on the screen in more detail on the coming pages, and I'll also give you some perspective on where we see the business headed in 2019. So, as we move on to page 3, our top priority was to align our cost structure with our business needs. Back in February of last year, we set a goal to reduce annualized operating expenses between $65 million and $85 million, thinking that roughly two-thirds of the savings would be realized during 2018. We now project annualized savings on a run rate basis to be approximately $120 million, $70 million of which was recognized last year.

In addition to the ongoing benefit of the cost savings initiatives, we also realized one-time working capital benefits with the elimination of our third-party distribution network and the right-sizing of inventory in our brick-and-mortar stores. Second, with the goal of improving store traffic at the core, we address the value proposition with a more targeted pricing approach across all product categories. Utilizing category-specific pricing to drive traffic increased our take rate and allowed for the reduction of promotional free time.

In Acceptance NOW, we lowered the total cost of ownership primarily through shortened rental terms and also lowered the barrier to entry with a lower down payment. We've seen a resurgence in our customer growth at the Core and our invoice volume at Acceptance NOW has risen on a per store basis since rolling out these programs.

Lastly, we focused on refranchising and preparing the organization to become a stronger partner in our franchise community. Last year, we closed on two larger transactions, one in the Southeast United States and one in Arizona for a total of 69 locations. We completed another transaction since year-end where we franchised 37 Baltimore area stores.

As you can see in the graphs on the bottom of the page, our strategy produced on both the top-line as well as the bottom-line. Consolidated same-store sales were up over 9% and the EBITDA trend shows how our plan quickly gained traction.

For 2019, the mid-point of our guidance for EBITDA is about $50 million above our 2018 results. That merely reflects the full-year impact of the cost savings initiatives implemented in 2018. So, needless to say, we feel we're well-positioned as we enter 2019. Also, while I don't want to steal Maureen's thunder, I would be remised if I didn't

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mention the improvement in our net debt by over $220 million since the end of 2017. Again, I'll let her go into more detail, but we put the balance sheet in a much healthier position and we're well-positioned to implement further improvements to the balance sheet upon resolution of our litigation.

Moving on specifically to our Core segment, we outlined our value proposition changes which ultimately turned into an impressive 8.8% same-store sales increase in the fourth quarter and 4.4% for the year.

In the fourth quarter, our Black Friday performance was the best we've ever seen from a customer growth perspective, and we're able to do it with a much lower amount of promotional activity than the prior year. The changes to the value proposition, our continued focus on capturing the significant increase in web traffic, and all the improvements we've made to the product mix played out in the critical fourth quarter.

A big opportunity you've heard me talk about before is capturing the web activity more seamlessly. And our field operators were able to grow web agreements by over 70% for the quarter. Executing on web-based leads will continue to play a key role in our strategy as we look to build off these promising fourth quarter results.

Additionally, product mix was strong with almost 50% new product going into the holiday as well as an improved localized assortment. At year-end, the portfolio, on a same-store basis, was up around 3% versus last year, which we feel is a great leading indicator for future same-store sales expectations.

Now, moving on specifically to Acceptance NOW, where we saw similar results as our changes to the value proposition drove a same-store sales increase of 9.6% for the fourth quarter. The same-store sales growth coupled with the cost saving initiatives and lower losses helped us end the year on a high note in Acceptance NOW as the adjusted EBITDA was $23.8 million for the quarter or better than last year by approximately $19 million; quite a turnaround.

I'm as passionate about the Acceptance NOW business as I was when we launched it about 10 years ago. We've already seen the improvements in 2018 drive growth and profitability. The enhancements to our value propositions coupled with the fact we can serve a broader spectrum of subprime customers than anyone in the industry, both banked and unbanked, give us an extremely compelling offer.

We also believe that resolution of our merger litigation will allow us to move forward with Acceptance NOW initiatives that have been on hold during this time, mostly regarding software enhancements, therefore, creating even greater growth and cost saving opportunities within this segment.

In 2019, our strategy remains consistent with what was laid out at the beginning of last year, we'll continue to actively evaluate cost saving opportunities, but we've not built any additional opportunities into our guidance for 2019. As I mentioned previously, the 2019 will benefit from the full run rate impact of cost saving initiatives implemented during 2018 or approximately $50 million in incremental year-over-year saving, that's without identifying any future savings that we believe we'll be able to do.

The value proposition enhancements are something we also continue to refine. As we identify customer purchasing or behavioral trends, we will evolve our product and pricing that capitalize on new opportunities. As I talked about earlier, we've seen significant growth on our web agreements, the E-commerce side, if you will, and plan to continue to make this a focal point of our strategy.

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I also want to reiterate our commitment to invest in technology for Acceptance NOW, with the goal of making the transaction more seamless for the customer and our retail partners. We see a very exciting future for Acceptance NOW, and we now have the balance sheet to invest and grow that business.

Last, we will continue to pursue refranchising as our third pillar. Building on our recent success, we have a solid pipeline of potential franchise partners and we'll execute on them throughout the year and into the future. Obviously, this is a little harder to predict given their reliance on a number of factors outside of our control, but we feel very confident there's a market there for franchising – for refranchising.

I'll now turn the call over to Maureen for some highlights on our financial results.

Maureen B. Short

Chief Financial Officer, Rent-A-Center, Inc.

Thanks, Mitch. Good morning, everyone. I'll cover some financial highlights for the fourth quarter and provide an overview of our balance sheet and cash flow. I will then close with our financial targets for 2019 before opening up the call for questions.

During the fourth quarter of 2018, consolidated total revenues were $661.8 million, an increase of 3.6% versus the same period of last year. Same-store sales for the consolidated business were positive 9.1% and improved sequentially in each month within the quarter. Adjusted EBITDA was $49 million in the quarter and EBITDA margin was 7.4%, up 870 basis points over the same period last year. Net diluted profit per share excluding special items was $0.35.

The special item charges taken in the quarter were $18.7 million, primarily driven by cost savings initiatives, Core U.S. store closures, and legal and professional fees associated with merger-related activities. In our Core segment, total revenues in the fourth quarter increased 4.9% versus the same period last year, primarily due to same-store sales increase of 8.8%, offset by the rationalization of the Core U.S. store base. This is the eighth consecutive quarter of sequential same-store sales improvement, and a 12.4 percentage point improvement versus the fourth quarter of last year.

Store labor and other store expenses were down over $20 million in the fourth quarter, primarily driven by approximately $13 million in cost savings initiatives and a lower store count. Adjusted EBITDA in the Core segment was $52.4 million and EBITDA margin was 11.2%, which was up 700 basis points versus last year.

Now, turning to the Acceptance NOW business, same-store sales increased by 9.6% in the fourth quarter, while total revenues decreased by 1.5%, primarily due to closures in 2017. Store labor and other store expenses were down $24 million versus the same period last year, primarily due to $10 million of cost-savings initiatives and lower skip/stolen losses.

Skip/stolen losses for Acceptance NOW were 11.4% of revenue, which was 230 basis points better than last year. Adjusted EBITDA in the Acceptance NOW segment was $23.8 million and EBITDA margin was 13.8%, which was up 10.9 percentage points versus last year.

Mexico grew revenue by 7.2% in the fourth quarter and generated $4 million in adjusted EBITDA for the full-year. In the Franchise segment, revenue increased by 41% in the fourth quarter due to an increase in merchandise sales driven by a higher store count associated with our refranchising efforts and a change in the way we account for advertising fee contributions.

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In accordance with the revenue recognition policy, we now recognize advertising fee contributions as revenue versus a contra expense. This policy also impacted the way we recognize franchise fees as they are now recognized over the life of the franchise agreement versus upfront when a transaction is completed.

Adjusted EBITDA declined in the fourth quarter by approximately $800,000, primarily due to these accounting adjustments and a one-time benefit in the fourth quarter of 2017. Corporate operating expenses in the fourth quarter decreased $5.9 million compared to prior year, primarily due to the realization of cost savings initiatives, partially offset by higher incentive compensation.

Moving on to the balance sheet and cash flow, for the full-year of 2018, cash generated from operating activities was $228 million, $117 million higher than the prior year, driven by stronger operational performance, our working capital initiatives, and a $35 million tax refund received in the fourth quarter. Free cash flow also benefited from lower capital expenditures and refranchise sales proceeds.

During 2018, debt was reduced by over $140 million by paying off the term loans and reducing to a zero balance on our revolving lines of credit. In December of 2018, the company amended the revolving credit facility agreement which reduced the capacity from $350 million to $200 million and extended the term to 12/31/2019.

Total available capacity on our revolver at the end of Q4 was approximately $95 million, taking into account our committed letters of credit and reserves. Total liquidity, including the $155 million of cash on hand at the end of the quarter, was approximately $250 million. The company's net debt to adjusted EBITDA ended the year at 2.1 times, significantly reduced versus the ratio of 8.6 times at the end of 2017.

To further expand on the improvements in the health of our balance sheet, the graph on slide 9 highlights the trend of our net debt during the past year. We also included our 2019 guidance midpoint on the chart, which show where we expect to end 2019.

If you focus on the second chart, it shows the year-over-year progression of our net debt which improved by over $220 million from 2017. As you can see, ending 2017, our net debt was over $600 million; and given the strong cash flow performance year-over-year, we were able to pay down our outstanding revolving credit facility early in the year, pay off the term loan balance in Q3, and build up an additional $83 million in cash on the balance sheet versus where we ended 2017.

Also regarding the balance sheet, starting in the first quarter of 2019, the company will implement the new lease accounting standard, ASC 842. The adoption of the new standard will result in the majority of our operating leases going on our balance sheet, but we do not expect significant impact to the income statement. For our rental contracts, Rent-A-Center does not recognize revenue in advance of payment, so we also do not expect material impact to rental revenue in future periods.

I also wanted to spend a few minutes recapping the 2018 results as it relates to the guidance we put out in December before moving on to our latest 2019 guidance expectations. 2018 was a strong finish for us as we met or exceeded our guidance across the board. Revenues came in towards the high end of the range while adjusted EBITDA, EPS and free cash flow all exceeded the high end of the guidance ranges.

Our ending cash beat the high end of the guidance range by over $30 million and was driven primarily by our higher bottom-line operational performance and certain cash payments originally forecasted to hit in December that actually ended up hitting in January. The timing of cash payments helped our 2018 results, but lowered our free cash flow guidance for 2019 due to the shift in the timing of payments.

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With that, we can look forward to our 2019 guidance. If you look at slide 11, it lays out our latest expectations for 2019. We recently refranchised 37 stores in the first quarter of 2019, and our latest guidance expectations have now taken into account the refranchise transaction completed in January which lowered our revenue guidance.

Total consolidated revenue is now expected to be in the range of $2.585 billion to $2.630 billion, only slightly down from this year with almost 200 fewer stores in the Core business to start the year. This speaks to the increase in the portfolio on a same-store basis that we've seen throughout 2018.

Adjusted EBITDA is projected to be between $220 million and $250 million as we benefit from improved leverage due to the full-year impact of our cost savings initiatives. Non-GAAP diluted earnings per share are expected to be between $1.75 and $2.15. Both adjusted EBITDA and EPS were unchanged from the guidance provided in December.

Free cash flow is expected to be between $115 million and $145 million, down from 2018, primarily due to the difference in our tax burden year-over-year, lower working capital benefit, and the timing of certain year-end payments which shifted from December into Q1, as I mentioned earlier. Our net debt expectation has improved due to better performance in the fourth quarter and proceeds from the refranchise transaction that took place in January.

Capital expenditures are expected in the same range as our 2018 spend of approximately $30 million, and the tax rate is expected to be between 22% and 23%.

The company is in active discussions with our bank group and expect to refinance the balance sheet during 2019. However, today's guidance does not include the impact of refinancing. Additionally, the guidance does not include any new refranchise transactions after January of 2019, any cost savings initiatives we may identify throughout the year, and the $126.5 million reverse termination fee associated with the termination of the merger agreement which is still the subject of litigation.

Thank you for your time. Now, I will turn the call over for your questions.

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QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Your first question comes from the line of Kyle Joseph from Jefferies. Please go ahead.

Kyle Joseph
Analyst, Jefferies LLC

Q

Hey, good morning. Congratulations on a strong close to 2018, and thank you for taking my questions. I'd want to just start out, your growth in both segments, Acceptance NOW and the Core, has been very impressive. And I'm just trying to wrap my arms around that given what we've seen from some other brick-and-mortar retailers and the likes. How much of that is driven by your initiatives? Are you seeing any changes in the competitive environment? Can you give us a little more color there?

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

A

Sure, Kyle. We've not really seen any changes in the competitive environment in brick-and-mortar side. I would say, mostly it's due to the value proposition changes we've made; the changes we made to the product inventory, more of a localized assortment; the web orders, as I mentioned, are up dramatically, we grew by 70% last quarter year-over-year. And, look, the web orders were like 60% higher than the year before, but our agreements were up over 70% higher. So, the execution is better on what we do with those orders.

So, I think it's a combination. I don't think it's very much to do with competition. It's more to do with, with us, the changes we made to value proposition, execution, and web orders, product flow and the like. And we – by making the changes to our value proposition, Kyle, we were able to not give away as much on the promotional side, so it helps the revenue as well. So, I think it's been mostly what we've done. I don't see much change in the competition out there on the brick-and-mortar side.

Kyle Joseph
Analyst, Jefferies LLC

Q

Got it. That's helpful. And then, you talked about Acceptance NOW and reinvesting in that business, particularly after litigation is resolved. Can you give us a sense? I know you mentioned technology, is that primarily from an underwriting perspective that you're investing in, or your plans there? And then, from a growth opportunity, I know you talked about your pipeline, just the balance between manned and unmanned kiosks in that business?

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

A

Yeah, that – sure, Kyle. The technology I was talking about is mostly not so much the decision engine technology because we have that already, and we use it even in our manned locations. But in the – the technology I'm referring to is, we're restarting now with the merger agreement being terminated, restarting the advancement of the technology to do more unmanned locations because we see the growth being a combination of manned and unmanned. And our unmanned platform is – hasn't been good enough, but it – soon it will be good enough to compete and grow dramatically in that business based on the technology enhancements that we're working on there now.

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So, as far as what that will mean store count-wise, we know the white space opportunity in Acceptance NOW is tremendous, especially when you have a combined offering of manned and unmanned like we'll have very shortly. And we haven't put any numbers to that yet; we will, as we go over the next quarter or so. But right now, we don't have – we really don't have any growth in our guidance, so we haven't talked about how much more we can do with that. It's going to help us grow. There is a dramatic opportunity to grow Acceptance NOW, like I said, there's also an opportunity to take – to be more efficient with our labor with better software.

So, I think you'll hear more about that over the next couple of months on the combination of what our growth numbers once those are further identified, as well as the optimization of some of the cost structure with better software on the labor side.

Kyle Joseph
Analyst, Jefferies LLC

Q

Great. Thank you. And one last one for me. Maureen, I heard the write-offs for Acceptance NOW, and apologies if I missed that, but did you get those for the Core – for the skip/stolen? Sorry.

Maureen B. Short
Chief Financial Officer, Rent-A-Center, Inc.

A

Sure. The skip/stolens in the Core business were 3.7% of revenue, that's a little bit versus last year. Part of that's driven by the higher end-product mix that's in our stores. Operationally, the charge-offs are a little bit higher. But for the year, our skip/stolens were 3.3% of revenue, well within our historical range.

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

A

We also had – I'm sorry, Kyle...

Kyle Joseph
Analyst, Jefferies LLC

Q

Okay. Go ahead.

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

A

...just going to add, we – the Acceptance NOW Maureen mentioned is, that was the best skip and stolen number in Acceptance NOW since 2015, I think, for the year, is the best one in four years, and the Core was well within our range and the – we also had in 2017 a loss reserve credit and the accrual because the credit had come down in 2017. When Mark came back for that year, he focused on collections, got it down pretty well in 2017 and got a credit the way the reserve accrual works. So, year-over-year, we were slightly higher mostly because of that credit in 2017, as Maureen said, slightly higher operationally charge-offs, but certainly not a material increase.

Kyle Joseph
Analyst, Jefferies LLC

Q

Got it. Thanks very much for answering my questions.

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

A

Thanks, Kyle.

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Operator: Your next question comes from the line of John Rowan from Janney. Please go ahead.

John Rowan
Analyst, Janney Montgomery Scott LLC

Q

Good morning.

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

A

Hi, John.

Maureen B. Short
Chief Financial Officer, Rent-A-Center, Inc.

A

Good morning.

John Rowan
Analyst, Janney Montgomery Scott LLC

Q

Mitch, you talked about a strong Black Friday sales. And the reason why I ask this or want to talk about what the early payout options were for those Black Friday sales, whether it's three months, four months, six months? As we sit here today with the IRS data that we're looking at, there's a big delay in tax refund specifically for refunds with earned income tax credits and additional child tax credits in them. And I believe that that delay pushes lot of those refunds outside of like a 90-day same-as-cash window. So, I'm just trying to gauge how much of those Black Friday sales had a longer than three months early payout option and whether or not you're seeing any change in the throughput from Black Friday sales to early payout options in 1Q based on this kind of specific cohort of tax refunds, which are actually quite a bit delayed versus last year?

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

A

Sure, John. Yeah, we did have the best Black Friday we had from a customer growth standpoint ever for the week of Black Friday. And then, to answer your question specifically, anything we rented in that period of time was – there's no one answer to that question. It's between depending on the state and depending on the product, it may be anywhere from 120 to 180 days same-as-cash. So, there's still room for that as far as even with the income tax refunds being slowed down.

Whenever you think about the same-as-cash kind of offering, most people talk about it in terms of days, 90 days, 120 days, 180 days, what is it, what's better and all that kinds of stuff. Keep in mind that the other really important thing there is what are you pricing it at. So, if you go – if you have 180 days, if that was the same price as 90 days, that might not be the best offering. But we don't – we move our prices around depending on product category and so forth.

So, it's not – just because you go from 90 days to 180 days doesn't mean – it doesn't mean margins go down, because you will have more payouts as you increase those number of days, which is a discount for the customer, but how much of a discount, how do we price it, what's our multiple on the cash price. So, it's an important factor to figure in there.

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As far as the income tax refunds coming in slower, it's always – it's a double-edged sword that – and we'll see over the next couple of weeks. Most people think they'll catch up and it's too early to tell where it's – where we're going to end up. They're certainly coming in slower, but two weeks from now, it might all be – it might all have just washed out normally. The double-edged sword, there's a lot of revenue from early purchase options. On the other hand, the less early purchase options, you get the portfolio of these base dollars. So, either way is going to work for us.

John Rowan
Analyst, Janney Montgomery Scott LLC
Q

But you're not doing the 90 days anymore, is that correct? Because I've been just trying to look through some old filings, I see 90 days and I also see the Worry-Free Guarantee on your website showing three to four months. I just want to make sure I understand where your current promotion activity is for a Worry-Free Guarantee here same-as-cash, whatever you want to call it?

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

Almost all of it's going to be either 120 days or 180 days.

John Rowan
Analyst, Janney Montgomery Scott LLC
Q

Okay. And then, just last question, you said that there was a refranchising in January, can you just remind me of the timeframe of when that happened? And if I'm not mistaken, there was an injunction from the judge regarding the Vintage merger and I'm asking specifically about that that did – that barred you from doing certain type of large corporate transactions until the lawsuit was settled?

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

Well, it was a restraining order until the lawsuit is settled, but there's an – there was an opportunity to get approval for that transaction. We got approval for the Baltimore transaction, closed it, I don't know, Maureen, mid-January?

Maureen B. Short
Chief Financial Officer, Rent-A-Center, Inc.
A

Right.

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

Yes, mid-January. That's why the revenue from the December guidance we put out to the guidance Maureen just talked about this morning is lower. Mostly, it's a revenue issue. There was a little bit of EBITDA, plus we get royalties. So, those kind of offset each other. And the revenue is where the big drop is in the guidance between December and January. So, short answer, though, John, is we had gotten approval to do that transaction.

John Rowan
Analyst, Janney Montgomery Scott LLC
Q

Okay. And last question, I am not a lawyer, so post-trial oral arguments, I just wanted to know is that toward the end of the conclusion of this – on the lawsuit, just I don't know every step of the way to conclusion? I'm not asking to comment on it, just where we stand in relation to the life of the lawsuit?

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

Well, March 11 is the post-trial brief oral argument, and we'll just have to see where it goes after March 11. We don't know how long it's going to take the judge to rule after that.

John Rowan
Analyst, Janney Montgomery Scott LLC
Q

But that would be the next step, would be ruling after the oral arguments, correct?

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

As far as – yeah. I'm not an attorney either, but, yes, I believe that's right.

John Rowan
Analyst, Janney Montgomery Scott LLC
Q

Okay. Thank you.

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

Thanks, John.

Maureen B. Short
Chief Financial Officer, Rent-A-Center, Inc.
A

Thanks.

Operator: Your next question comes from the line of Budd Bugatch with Raymond James. Please go ahead.

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.
Q

Hi. Thanks for taking it. I was – I want to just delve a little bit more to what John was talking about, the cadence of EPOs, can you maybe, Mitch, describe what the cadence is this year versus last of EPO with a 180-day same-as-cash offering?

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

Well, generally speaking, they're a little bit higher than when we had 90 days or 120 days, not – really not significantly higher. They're a little bit higher. They have a dramatic increase in customer acceptance and so forth. So – but they're just – they're a little bit higher.

Of course, in February so far, it's hard to say because the income tax refunds are coming in slower, and we won't know for the next couple weeks what happens with the tax refunds. But then, it's – from a general answer, not talking about the refunds because we're right in the middle of the refund season and we're not going to know how that ends up for a couple weeks. But generally speaking, it's slightly higher, but I would say pretty immaterially higher.

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Beryl Bugatch
Analyst, Raymond James & Associates, Inc.

Q

And slightly – is there any quantification you can give just slightly?

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

A

Well, our – we talk about 25% to 30% ownership from our customers in the past with our new value proposition, which [ph] isn't (33:44) just 180-day or 120-day, there is – we've also made some changes to our overall pricing. Our early purchase option beyond the same-as-cash timeframe and we're up – you'll see it in the K, we're up to close to 35% ownership, so from the high-20s to 35% is the difference. That's not all because the same-as-cash, it's just the overall value proposition is driven it from the high-20s to 35%.

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.

Q

And the 180-day, is that a permanent offer now?

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

A

Well, again, we – I mean, some of our products depending on the state or the 120-day also. I wouldn't – permanent, hard to say, as the consumer changes, as the consumer is looking for something different, we may change it. Again, it's not just about whether we are 180-day or 120-day or 90-day or whatever, it's about what's the price for that product. And you can – there is ways to make more money on 180-day than you're making on 90-day.

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.

Q

Excuse me, if it's furniture where you might have a slightly higher margin, is that what you're referring to, is that the way that you think about that?

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

A

Well, certainly, furniture is a higher margin. And on the margin side, when you're putting a multiple on the cash option, you don't have to use the same margin, the same multiple for every product category, or you don't have to use the same margin at 180-day that we were using at 90-day. So, price has a lot to do with it. And our gross margin dollars are way, way up and the percentage is down like 20 basis points or 30 basis points. So, it's really had a de minimis impact on margin percent and, obviously, a glorious impact on margin dollars.

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.

Q

Yeah. I mean, the inventory on rent comparison's pretty impressive. The number of Core stores in the comp calculation, now you do have a comp calculation that has a removal for stores that are merged, what's the percentage of stores or comp stores, the percentage of Core stores that are in the comp?

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

A

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I think, Maureen, it's about 75% there in the comp?

Maureen B. Short
Chief Financial Officer, Rent-A-Center, Inc.
A

Yeah.

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

Like 1,500 or so are in the comp?

Maureen B. Short
Chief Financial Officer, Rent-A-Center, Inc.
A

I think that's about right. You'll see the details of that broken out in the K. We plan to file the K this coming Friday.

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.
Q

Okay. All right. Well, that's good to know. And in – on the charges for the cost savings, tell me what's in the charges, how long do they persist? Are we seeing more – do we see more going into 2019?

Maureen B. Short
Chief Financial Officer, Rent-A-Center, Inc.
A

We do have continued costs associated – one-time costs associated with the implementation of our cost savings initiatives. What we've included in our 2019 guidance is about $25 million associated with lease obligations, remaining lease obligations and severance costs associated with the closure of our product repair centers, which closed towards the end of 2018, and the 125 – the approximate 125 store closures were planned for 2019.

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.
Q

And when will that – when do you think you'll see that $25 million reversal or $25 million charge?

Maureen B. Short
Chief Financial Officer, Rent-A-Center, Inc.
A

A lot of it will be in the first quarter. With the new accounting – lease accounting guidance, there may be a shift in the way that the timing hits of those costs. There shouldn't be a change in the amount of costs that we're evaluating what that looks like from an accounting standards implementation. Typically, we take those charges all upfront as we either exit a facility or close the stores. But the cadence of that may look a little different with the new accounting standards.

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.
Q

And speaking about the new accounting standard, what do you think the impact on the balance sheet is? I know you must have a preliminary estimate. I know that that can still change, so you won't see that until the end of the first quarter. But what should we take it as a reasonable estimate for the balance sheet impact of the present value of right-of-use lease obligation?

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Maureen B. Short
Chief Financial Officer, Rent-A-Center, Inc.

A

We're in the process of implementing a new lease accounting tool to help us quantify that. We haven't included an estimate in the 10-K. But looking at the lease obligations in the five-year table, the reasonable estimate will include our store leases, the fleet associated with our vehicles, and there are a few embedded leases that we have. But you'll see more in the first quarter results as far as how it's outlined on our balance sheet.

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.

Q

And the number – what kind of – what number is that five-year obligations that's a PV number? What number is that now?

Maureen B. Short
Chief Financial Officer, Rent-A-Center, Inc.

A

See, I don't have that in front of me, Budd. But when we talk later, I can provide those numbers.

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.

Q

Thank you. Mitch, customers per store rising, what was the max customers per store average? I mean, we see – if we go back in history, what was that? Do you recall?

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

A

No, because we look at customers and agreements. We're not up – we're not to the max yet, I know that. When we think about the agreements per store or the portfolio balance per store, we still got room to grow and, as I've said, but we're – we ended the year with a portfolio in those same stores being around 3% higher than last year and continue to believe we can add on to that.

The web traffic is, as I said, at all-time highs. We're executing better. The orders went up about 60%. As I mentioned, in 2018, in the fourth quarter, I should say, and – but our actual orders were up 71%. So, the customer – for all the people that want to see brick-and-mortar is dead and retail is dead, we see plenty of customers coming to us, of course, more come from the web than ever before, and we have to continue to execute on those and continue to grow that portfolio, but the short answer to your question is, there's still room to get back to our historical highs.

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.

Q

And what about revenues per customer or agreements per customer? How is that trending?

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

A

It's very consistent. Budd, that almost doesn't move, over the years, that's been very consistent.

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.

Q

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Okay. And in the guidance, how many stores are in the Core at the end of the year or what do you think closures would be? I know we've got 37 franchise stores coming out. How many do you think you will franchise during the year [indiscernible] (40:46) and how many will you close or merge?

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

A

Hard to predict on the franchise side. We'll do deals that make sense for us from a financial standpoint, if we think a franchisee can improve the performance of an area, so there'll be – certainly, we're going to do deals that make financial sense for us and for the potential or the prospective franchisee.

Also, we see franchising – it's interesting you ask it that way, Budd, because I see franchising as a growth vehicle for us. When we sell markets like Baltimore, it comes with an obligation to open more stores. And as you know, we have been opening stores in our Core business, the company-owned stores. So, as we sell the transactions we did last year, those two that I mentioned, and the one we did already this year, all three of those have growth requirements in it by the franchisee.

So, refranchising some of these markets can be a growth vehicle for us. We're not – we don't have a number that we've got in our guidance. We don't have anything in our guidance other than what we've already done in January. So, it's hard to predict, because we're going to do deals that make sense and we don't want to force ourselves to a number either. We want to make good financial deals, and so we're not going to forecast that, predict it. On the closures, we believe it's in the 125 area this year as far as how many we'll close, and we'll have some growth with the franchisees, not just selling them some stores, but again, them opening stores. But we don't have that number identified today.

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.

Q

So, if I'm doing the math right, we should have about 162 less stores at the end of 2019 than we have now kind of [indiscernible] (42:32) and that's kind of the way the guidance was framed?

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

A

In the Core business, yes.

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.

Q

100 – yeah, 125 and 37.

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

A

Yeah.

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.

Q

Okay. All right. My last question – well, I'll let others do. Thank you very much. Good luck [indiscernible] (42:50).

Operator: Your next question comes from the line of Vincent Caintic from Stephens. Please go ahead.

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Vincent Caintic
Analyst, Stephens, Inc.

Q

Hey. Thanks. Good morning, guys. Most of my questions have been asked, so I just have a couple of quick ones. On the updated guidance, so I understand that it was primarily because of the franchise sales, so you have about $30 million lower revenue guide. Your EBITDA and EPS guidance is unchanged, though. So, is – should I – we take that to mean that the franchises also had $30 million of expense or was there maybe $30 million of additional savings that you found somewhere else?

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

A

No, those stores have $30 million of revenue and close to that from an expense standpoint. There's a little – and then, there is an EBITDA drop there because they were profitable stores. But now we get royalties from the franchisee as well. So, the difference was pretty de minimis than what our EBITDA was versus what the royalties are going to be going forward. So, it's really just the revenue drop.

Vincent Caintic
Analyst, Stephens, Inc.

Q

Okay, got it. That makes sense. When you think about franchising going forward, is that – is it sort of the math construct when you're looking at other opportunities, or are there others where you get kind of a more of an EBITDA lift or any other way that we should think about franchising going forward from an economic perspective?

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

A

Yeah, good question. I think there's – there are certain stores we'll sell where there'll be actually a lift in EBITDA. There's some where there may be a bigger drop in EBITDA. But if there is a bigger drop in EBITDA, the sale price is going to have to be significantly higher on a per store basis than what you're seeing in those last couple of transactions. So, it's all about the better stores sell for a lot more than the weaker stores. And that's why it's hard to predict. It's very selective. We'll do deals that make financial sense. And even though it sounds like a generic answer, it is a generic answer, because you really have to look at each one individually and selectively and figure out if the – the better the store, the higher the price has to be, or we won't sell them and vice versa.

Vincent Caintic
Analyst, Stephens, Inc.

Q

Okay, got it. That makes sense. Separately on – so on the revenue side, so I understand that this is a portfolio business, so I'm kind of wondering, when you give your 2019 revenue guidance, is there a way to say how much of visibility you have in that revenue guidance? So, is there – would you be able to put a number to say we've already – say, our portfolio already has contracted 60% of the revenues we have in our 2019 guidance, or is there kind of a way to think about it since your average term is about 16 months that you should be able to see through 2019?

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

A

Well, yeah. You have some – there's some vision to it – visibility to it. The average term is 16-month, but actually on-rent the average is more like 5 months as far as versus what we write in the rent-to-own contract versus what actually happens. So, we have some visibility. We already said we went into the year with our portfolio being 3% higher than where it was a year ago. There's still a little room to add on from a collection standpoint or less

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promotional standpoint, so maybe add a little more to that, but there's really – I mean, there's two ways you grow your same-store sales in this business, you grow the portfolio or you collect your money better.

The portfolio is 3% higher going into the year, we think we can add to that. And there's some opportunity to collect better. If you think about our guidance from low-single digits to mid-single digits, we started the year 3% ahead in the portfolio, and as we go through the year, we can add on to that. So, we're already, as we go into the year, in pretty good shape relative to the guidance.

Vincent Caintic
Analyst, Stephens, Inc.

Q

Okay. That's helpful. Could you talk about the collection side of it? So, when you talk about improving collections, when you think about it year-over-year, anything – any actions you can point to that's going to improve year-over-year?

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

A

Well, a lot of it – collecting our money starts with what our promotion is and how much money we give away on the front-end. And when you have the best value proposition in the industry like we now have with using either 120-day or 180-day same-as-cash and the competitive pricing we have – targeted pricing depending on the product category, when you do that, you don't have to run as many low barrier to entry promotions like $5 rents for the first week and so forth. You can – you still do some of those, but you don't have to do as many.

So, you can collect more by being less promotional, and then just once it's on rent, how's your collection rate, and our collection is in pretty good shape right now. The operations team is doing a good job with that. And there's still another – when I combine promotional and what we collect after the fact, it's probably another percent that we can get out of that this year when I add those two together. So, when we started thinking about 3% and the portfolio going into the year, we can add to that because our traffic remained strong. We can add another percent based on the collections between promotional and credit, if you will. So, we can get – the high end of the range, that mid-single digit is very, very doable.

And as we – one of the things we're really focused on is signing our customers up on AutoPay which helps with that collections, so you can get another – you just collect your money faster and better if you get them on the AutoPay program. So, lot of things going on there. I mentioned the web traffic and, of course, the web customer is the one that's easier to sign up on the AutoPay because they're already on the web. Our new marketing team, with Ann Davids coming back, has done a wonderful job driving more traffic to the web and we're executing on it, so.

Vincent Caintic
Analyst, Stephens, Inc.

Q

Okay. That's helpful. And the last one for me, just a follow-up on John Rowan's question about tax refunds, is there – I guess, you're seeing it somewhat slower activity, what's the general impact that you see at the store level? So, is it more of maybe there's less payouts, but there's more – more people are taking out to try to kind of tie it over the next couple of – two months or so, or are you actually seeing more activity or what generally are the tax refund impacts that you're seeing year-over-year?

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

A

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Just you see less payouts, which, on one hand, is less revenue today, but the portfolio stays higher than we forecasted. So – and then, as the payouts do catch up, like they would in a normal tax season, that's what we expected anyhow, and then that – the impact on the portfolio will be there, but then you have a lot of cash from the payout. So, either way, like I said earlier, then either way, you can make – it works either way, either you have a lot more revenue and a little less portfolio, just the way we forecasted, or if we have a little less payout revenue, but then the portfolio is higher and we get more revenue every month going forward the rest of the year. So, either way will work for us.

Vincent Caintic
Analyst, Stephens, Inc.
Q

Okay, got it. Thanks very much, Mitch.

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

Thanks, Vince.

Operator: [Operator Instructions] Your next question comes from the line of Brad Thomas from KeyBanc Capital Markets. Please go ahead.

Bradley Thomas
Analyst, KeyBanc Capital Markets, Inc.
Q

Hey, Mitch. Hey, Maureen. Thanks for taking my question. Good morning.

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

Hi, Brad.

Maureen B. Short
Chief Financial Officer, Rent-A-Center, Inc.
A

Good morning.

Bradley Thomas
Analyst, KeyBanc Capital Markets, Inc.
Q

I wanted to follow-up on the topic of customer growth, which has been really encouraging to see. I guess, I was wondering, if you all could share any comments on what you're seeing in terms of new customers coming into the stores versus, perhaps, existing ones that you're convincing to come back to the business?

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

It's been very strong on new customers and reactivated customers. The tremendous increase we've had on our – through our website, the E-commerce, web orders, if you will, the 62% increase in the fourth quarter, a lot of them are new customers. Like I said earlier, our value proposition is working. Our localized store product assortment is working for the customer. And, yeah, so it's a lot of new customers as well as reactivations.

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Bradley Thomas
Analyst, KeyBanc Capital Markets, Inc.

Q

Great. And as you think about the drivers of customer growth going forward, Mitch, I mean, how do you feel about things and what level of confidence do you have that you can continue to drive positive same-store agreement growth six months from now and 12 months from now?

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

A

Well, we're very positive about it. Our guidance is low- to mid-single digits from a same-store sales perspective. The product offering is strong, the execution is getting – continues to improve on the operations side with customer traffic and the web orders, as I mentioned. And we're doing a lot of different things through Voice of the Customer platforms, mystery shopping to keep our operations folks focused in on their toes.

So, I think we can continue to drive it. We're still not back to historical levels. So, the company had dropped for a few years in a row. So, there's still plenty of opportunity to grow, and as I said earlier, and grow stores through the refranchising efforts, not just grow our same-store sales. So, we're very optimistic about our future, and why wouldn't we be coming off of a quarter with 9% same-store sales.

Bradley Thomas
Analyst, KeyBanc Capital Markets, Inc.

Q

Absolutely. If I can ask about CapEx, your guidance of $25 million to $35 million is – seems a bit light if you looked at expenditures over the prior – five years prior to you joining, Mitch. I think it averaged about $80 million a year. Could you just talk about what you're able to achieve with that level of spend and how sustainable that level is for the organization?

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

A

Sure. I think we get that question quite a bit as if we're starving the stores or something. And just because we are spending at such a high level, doesn't mean we – by not continuing that means we're starving anything. A lot of that, as you know Brad, was the new POS system that rolled out in 2016. So, that was – from a technology standpoint, we're much more targeted in what we're spending our money on. We're not – we are – we've got some technology initiatives, one I already mentioned. We've got some going on. It's just more targeted.

And the reimaging program for the stores is just a more cost-effective program. It's not like we're not reimaging the stores. So, I think it's just – I think we just got smarter, and it's a more cost-effective reimaging program for the stores and a more targeted approach to technology investments. And I – Maureen, I don't know if you have anything to add to that. I think we just got smarter on how we spend the money in that. We're not starving anything.

Maureen B. Short
Chief Financial Officer, Rent-A-Center, Inc.

A

Right. We invested heavily in technology over the last few years, and a lot of those projects are complete. We've also reimaged almost all of our stores within the last four to five years. So, as we go into stores to reimage them, it's more like a paint and carpet versus a full remodel of the store. So, definitely, we feel like both the technology investments and the store maintenance are at appropriate levels.

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Bradley Thomas
Analyst, KeyBanc Capital Markets, Inc.

Q

Great. And if I could squeeze one last one in here. I think it was about a year ago that the company explored the opportunity to sell itself, came to an agreement with Vintage, ultimately, you all made the decision, do you see it legally you had the opportunity to walk away from that transaction and the stocks trading today higher than what it would have been if the company had sold itself? But, I guess, as you think about where you are today, should the litigation with Vintage get wrapped up, do you still feel like Rent-A-Center is best positioned to remain a public company or does the board feel like it should perhaps again review strategic alternatives given where it stands today from a financial perspective?

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

A

There's no – we – our strategy won't be a go back into a strategic review process, it will be just continue to operate. Of course, we always have the best interest of our stockholders in mind, so always look at alternatives. But there's no plan once the litigation is wrapped up to go back into a strategic review process.

Bradley Thomas
Analyst, KeyBanc Capital Markets, Inc.

Q

Great. I appreciate that clarification. Thank you all and congratulations again on a very strong year here.

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

A

Thanks, Brad.

Maureen B. Short
Chief Financial Officer, Rent-A-Center, Inc.

A

Thanks, Brad.

Operator: There are no further questions at this time. Mr. Fadel, I turn the call back over to you for closing remarks.

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

Thank you, Jessa, and thank you, everyone, for your interest today. I hope the presentation be enough as we try to talk to the presentation, I hope that works for everybody. It's a new thing for us. We've seen a lot of companies doing it. We thought we would do it ourselves, seem to work okay. And now that the presentation is out there on our website for anybody to review and review against our transcript and those kind of things. So, I hope we found that helpful. We enjoy reporting to you, of course, when the numbers are good like this. It's easy, right? So, lot more fun. So, we're going to go back to work, try to put another great year together, and we appreciate your support. Thank you, everyone.

Operator: This concludes today's conference call. You may now disconnect.

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