Corrected Transcript

09-Jun-2020

Rent-A-Center, Inc. (RCII)

Stifel Cross Sector Insights Virtual Conference

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MANAGEMENT DISCUSSION SECTION

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

Thank you and good morning. This is John Baugh at Stifel, and welcome to the 10:40 AM Eastern Time Standard with Rent-A-Center. We've got a half an hour and very pleased to have with us Maureen Short, who is the CFO; and Mitch Fadel, the CEO. I've asked Mitch to make a few opening comments. Thereafter, I'll ask some questions and of course participants are welcome to ask questions over the Internet cast and I'll pose those to management hopefully within a half hour.

So with that, Mitch, I think we'll turn it over to you.

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

Thanks, John. Good morning, everyone. Thanks for joining us this morning. Thank you, John, for putting this together and thanks to Stifel. Probably some of you are familiar with Rent-A-Center and some of you aren't. I'll give you a brief overview and then we'll get to questions. Rent-A-Center has been around a long time, been public since the mid-90s. I've been in this business since 1983, left for a little while and came back almost three years ago now, two-and-a-half years ago now, so pretty experienced in this business to say the least. I guess we go back to 1983. Most of my adult life I've done this.

So anyhow, Rent-A-Center has really we have two different segments, two significant segments. Ones are – Rent-A-Center segment that is our brick-and-mortar stores, about 2,000 company-owned stores plus franchise stores totaling about 2,300 in all. And with the Rent-A-Center segment has the Rent-A-Center Business plus our e-comm business which is the fastest growing segment part of that segment. the stores do the final mile for the e-comm business, which is the fastest-growing part of that segment.

The stores do the final mile for the e-comm business, so they're kind of tied together. They manage the accounts and so forth, do any returns and so forth. So the stores are part of the e-comm. And so, unlike like a traditional retailer, they have to have a different infrastructure for e-comm. We as our stores is the final mile, and it works very efficiently and at pretty good margins.

Our other segment that's our growth vehicle right now is our Preferred Lease segment, which is a retail partner business where we, as I said, partner with retailers to either supplement their staff and do a lease-to-own option within their retail store. We can do it virtually, we can do their e-comm, so a lot of different options there.

We've been in that model for a while, although we're stagnant with just the staff model. We bought a virtual player last summer, last August, and added a virtual solution to our repertoire. Some of you may have seen last week we added an EVP of that segment, a very highly qualified fintech person, Jason Hogg, to come on board because that is our growth vehicle and we see a lot of opportunity there.

Right now, through coronavirus, we've been able to perform pretty well. Like we said in that press release on June 3, our sales remained strong I think for a couple of reasons. One is we have household durable goods on both the residential side and even in the retail part of our business. So I think for the home right now, [ph] who (00:03:30) thought that the credit is already tightening, so lease-to-own becomes more of an option. The flexibility of lease-to-own becomes a better option for people.

We don't necessarily have to tighten our collect – the way we approve people just because of credit tightening. In the lease-to-own business, you can return the product if you can't afford it. We rent it to somebody else. So we don't have big bad debt problems. Like I said, if somebody can't afford it, they can just simply return it. We rent it to somebody else.

So we performed very well. If you go back – and John has been following us a long time – you go back to 2008 financial crisis and the lease-to-own business outperformed through a recession for the reasons I just said. I think this one will be even better because it's a stay home kind of recession, which is good for the products that we carry.

So things have gone well for us. As bad as coronavirus has been for many people, for us, it's going well for the reasons I've said. The credit tightening up above us. We think we have a long runway. Our e-comm business has grown up at over 100%. So we're pretty excited about where we are today and look forward to answering some specific questions.

QUESTION AND ANSWER SECTION

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

Q

Okay. Well, that's my job. So I'm going to go right at it, Mitch. Last we conversed, you've seen that strong mix shift in the stores to certain things like appliances and laptops and [indiscernible] (00:05:14) what's transpired from a mix standpoint as we go on through this? Is it more even now? What's your overall read of mix and therefore margin on a merchandise basis?

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

A

Yeah. It's really interesting to have followed this for the last 90 days. Yeah. So we follow it on a daily basis; it's not hourly. It's started out where appliances and computers were hot for us, essential products that as people were – with the stay-at-home orders. And now it's furniture [ph] special, (00:05:50) our number rental item. Furniture's coming back strong, which you mentioned margins which is a good thing because it's the highest margin product.

With the furnitures back, it's no longer just about essential products; it's all about anything for the home now. And [ph] we've seen that (00:06:10) on the retail partner business side too, John, when the retail, oh, we got a lot of furniture partners. They're some of the biggest ones in the country with Bob's and Value City and Rooms To Go and Nebraska Furniture Mart, and they are – and Ashley, of course – and when they're reopening, the pent-up demand for furniture is high. And so, it's evened out which is, like I said, is a good thing. Furniture's our number one category again.

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

Q

Oh that's good. Yeah, we've heard very good reports on the furniture side of the world. So I'm not surprised to hear that. Where are we with the – are all the stores open? Talk about the operations and what's fully functional, maybe what's not and how you've transitioned through the quarter-to-date.

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

A

Yes. All of the stores are fully open now with New York City opening back up earlier this week – yesterday actually. So we're fully open everywhere. When this started back in the middle of March, March 11 or 12, by the end of March with stay-at-home orders, we were able to keep most of our stores open being an essential business because we carry appliances and laptops.

But about 25% of our stores on the Rent-A-Center side had to keep the showroom closed, even though they could stay open, do business as an essential business but couldn't let anybody in the showroom. So they had to just curbside, just Internet, just phone orders and so forth. So they operated at – and we've said this. Well, they operated at about 70% capacity by doing that. Now it's about 25% of the stores. So 25% of the stores operating at 70%, so it wasn't awful but still nobody wants to run at 70% capacity on 25% of your stores. So that was the worst it got for us in the end of March and then it's gradually come down and like I said, with New York City showrooms being able to open yesterday, we're 100% open and so everybody is on full capacity or more. Like we said, the days sales remained strong.

[ph] And on the (00:08:22) Preferred Lease side, the retail part of the business, there's still a handful. The [ph] bulk (00:08:28) will open over the next couple of weeks, not many, somewhere in the 50 to 70 store range out of all of our retail partners, so there's not a whole lot not open yet on that side and, by the end of June, it will all be open. So now that business, on the other hand, because there was a lot of them [ph] that they (00:08:44) weren't essential, some of the furniture stores, we got up to 75% to 80% closures on that side of the business but we're pretty much fully open there and we'll be 100% by the end of June.

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

Q

Perfect. And then maybe touch on positioning on both sides of the business, the stores and Preferred Lease. And did you really change through it all because you have the benefits plus unemployment insurance on the store side? I'm just curious whether you really took a step back and now in terms of approving applicants or not, and your losses I assume are in pretty good shape but maybe you can update us there as well.

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

A

Yeah. We don't – in the lease-to-own business, we don't have to pull back the way the lenders do, and that's why we outperform in a recession, the lenders pull back and we get more business falling into the lease-to-own category. And we don't really have to pull back ourselves because it's a lease and not a sale. If a customer can't afford it, they simply return it, and we rent it to somebody else. So we've got more demand to rent it to somebody else because they're taking credit above us.

Also, as you know, John, about 70% of our customers come back when they get their feet back on the ground. We run about 70% repeat business. They can come back and rent a similar product, get some credit off their old product [indiscernible] (00:10:19) we give them some time off of the one they rent if they had to return and proceed to equity. We give them a good deal to come back like any business would, like the loyalty program.

So we don't have to tighten out and that's why we outperformed in a recession [indiscernible] (00:10:37) go up. If they could go up – I think we said it on our earnings call, we factor in a little bit more but not material amount because they can return it. It was not a financed contract where if a customer can't afford it and the lender wants money, the customer doesn't have money so you're stuck. In this case, we'd like to get paid. If we can't get paid, we just pick it up or rent it to somebody else.

So for our losses to go up, customers have to change into keeping a product that is not theirs yet because they haven't bought it. So a customer has to change their mentality into keeping something that doesn't belong to them. And so psychographically, you have tend to turn into a [ph] beef (00:11:25), if you will, to be perfectly blunt about it. So that's why the losses don't spike for the lease-to-own business.

What you can have is a few more returns. We haven't seen that because this unlike past recessions is a stay-at-home recession, so people don't want to return the stuff and they're figuring out how to pay for it. Obviously, stimulus has helped a little bit. Supplemental unemployment benefits have helped a little bit. But even without those, we don't see it changing a whole lot because people want to keep the stuff in their home.

Demand will be strong going forward with or without stimulus, with or without the CARES Act based on credit tightening, based on what we've seen in past recessions. So we think this one will be even better for us because it's a stay-at-home recession versus a financial crisis. So it's a good time to lease-to-own business. I don't know how else to say it.

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

Q

Yeah. And you mentioned credit tightening. What can you see in terms of applicants for a lease contract? What, if anything, are you seeing coming in that, if anything, that suggests you're starting to see some of those heretofore and sort of low-end credit customers show up in your transaction?

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

A

Well, we have our own scoring model. So it's not a credit score but our scores of people coming into our funnel have gone up. So we're seeing a higher-quality customer come into the funnel. Like I said, we don't necessarily have to tighten it just for our customers coming into the funnel.

We've also – one of our larger furniture partners on the retail side told me that – I won't mention the name of the partner, but they said their prime lender has dropped their approval range by 4 points since this started and probably, and those executives thought [indiscernible] (00:13:30) gets worse from here. And you don't have to have inside information to know that.

All you got to do is listen to some of their calls, whether it's Synchrony or any of those kinds of lenders. They're all tightening up. They have to for a lot of different reasons, banking regulation reasons and the like. And they're tightening up. That particular retailer said 4 points already. And we're seeing it as people drop in our funnel as we score them. So it's a positive for the lease-to-own segment for sure.

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

Q

And, Mitch, how do you think about – because you likely are benefiting from the stimulus and the CARES Act and all these things. And how do you think about when those things expire? Obviously, jobs are coming back, too, which is a plus, but what are you going to be looking at and watching closely, and when do you think that all sort of plays out?

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

A

Yeah. I think that – a couple of things we're looking at. When you think about the CARES Act expiring in a month or two, I'd say the end of July, you answered it earlier, John, we've got our product called Benefits Plus in our stores, where about 70% of our customers – a little over 70% of our customers have this benefit package with us. And one of the benefits in there is unemployment insurance [indiscernible] (00:15:02) and underwrites it, so if someone becomes unemployed, they bring the paperwork in or we get it online and pays their bill for them so they can keep their product up to $1,000 per customer.

Now so, we see the claims have gone up, but they're probably not as high as most people would guess, three or four a store, which I guess with a couple of thousand brick-and-mortar stores, and [indiscernible] (00:15:33) – over 3,000 locations with three or four a store so, call it, 10,000 claims or something, but it's only three or four stores as far as people actually looking for unemployment help with us of our current customers. So it's probably not the impact most people think.

Now that's a nice benefit to have, 10,000 claims and then they'll pay up to $1,000 on for the qualified customer. So it's a good benefit for the customer, good benefit for us. But it's not like 20% of the stores is [indiscernible]

(00:16:05). We're talking about less than 1% of the store customers are needing help from an unemployment standpoint. So I don't think it's probably as widespread as most people think.

I also think that there'd be plenty of demand. Even if that doesn't get renewed and that expires at the end of July, you know what? I said it this way to someone earlier this morning. I think without stimulus or without the CARES Act, if you say none of that's here in August. Tell me what you think. Well, I think it probably won't be as good as May and June, but year-over-year, it'll still be better than last year because of taking credit and people staying in their home [indiscernible] (00:16:51) product. So does it go down a little bit? Yeah. [ph] Does it double all last year? (00:16:56) No, I don't see it for the reasons I just said. When I say it did, I'm talking about demand.

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

Q

Got it. Got it. Preferred Lease, you're building out your team, your capabilities there. Maybe you could update us on the progress, what specifically you've done and what the goalposts are, and then speak to the sort of TAM, the total addressable market there and the growth you outlined a few years ago.

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

A

Yeah, there's an awful lot of white space. I think we see it as – what do we see in our deck, Maureen, $25 billion or $30 billion in total?

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

A

$25 billion.

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

A

$25 billion. And then I would've conservatively calculated. You know what you can do with those kind of numbers. We've seen reports that have said over $50 billion. We end up using $25 billion because it's big enough and it's a forecast of the opportunity. So it's a tremendous opportunity out there. We made that acquisition last summer. We've got the virtual repertoire that we need now to go into any store or tie into their POS, use a waterfall, use a third-party waterfall, whatever that retailer is using. We can do it over the phone, text to apply kind of stuff. We can do it online. So we really have the capabilities that we need.

Of course, you have to customize [indiscernible] (00:18:33) any retailer you sign up. We've got the team that can do that in a very short period of time depending on the retailer. We've added a national sales guy. The sales team continues to grow. Some were on furlough and there weren't much they could do during the coronavirus but they're all back now. And so the sales team's back and growing. We've got a national salesperson as well just working on the big accounts.

We added a – later this month, we had a fintech executive, Jason Hogg. We sent the press release out on last week. And if you look him up, if you look up his LinkedIn profile, just a tremendous background in fintech. So we've got the capabilities. We're building the team, and he was really the last piece of the team. As we built all this, we thought, wait, there's one more missing piece where we probably needed one more top-notch fintech executive to guide us going forward, and that's why we're bringing in Jason here later in June. So we're really excited about that opportunity.

We think retailers are going to be – we're seeing that already – even more open to it than they were before. And retailers as you've seen, John, have come around over the last 10 years saying, yeah, I never thought of lease-to-own before but now I guess others are doing it. So, I guess I should look at it but in the last three months, I think anybody willing to look at it before, probably there's not too many of them left.

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

Q

Yeah. That was actually going to be my next question, which is whether or not this pandemic you've seen any change from – you I'm sure are having discussions with various potential retail partners – whether you sense any movement in their thought process.

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

A

We have. We do think that there – those who maybe said [ph] well maybe, we'll see, (00:20:24) are much more interested in [ph] the not knowing credit's tightening (00:20:28) up above the lease-to-own transaction. So, yes, [indiscernible] (00:20:32).

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

Q

Interesting. I guess it wouldn't be a lease-to-own call without asking about regulatory issues, if there are any. I would assume focus is elsewhere but I don't like assuming things. Any updates?

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

A

No. It's all good there. For those of you who don't know it, we've operated from number of years going all the way back to the early 1980s with the first state I think was 1983, the year I started, the first state I think was Michigan that passed the lease-to-own law but now there's 47 states, District of Columbia and Puerto Rico that have laws that say it's a lease and not a sale and we operate under, so none of them ever flipped over on us.

And no, we think in a tough economic environment that probably, if anybody was worried about regulatory, we think there'd be less to worry about today. We haven't been worried about it for a number of years anyhow, but we know people do worry about it but I will just say in a tough economic environment, anybody who is worried about it probably has less reason to worry about it. But, no, nothing new there. It's all good.

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

Q

Good. And has the pandemic caused any material structural changes in cost of doing business? And I assume there's offsets like the price of fuel's got to be down. What are the puts and takes in terms of having to operate maybe more permanently in this new world?

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

A

The good news for us – yes, certainly the cheap prices are good for us, and good for our consumer mostly, and certainly good for us because we got thousands of trucks on the road. So it's good from an expense standpoint, but probably even more importantly good for consumer demand from our standpoint.

But the good news for us [indiscernible] (00:22:30) a little more about the expenses. But when you think about our e-comm business growing leaps and bounds like everybody's is, we've already got the infrastructure. Our 2,000-plus stores provides the final mile for all of our e-comm orders. And e-comm's a bigger part of the business and doubles as it is right now. [indiscernible] (00:22:54) 25%, 30% growth before that.

And even if you go back to 25% or 30% or you're 100% or you're somewhere in between, we don't have to add any infrastructure costs. We've already got the infrastructure [ph] of the stores to do the (00:23:05) final mile. And unlike retailers that when the business shifts to e-comm, they got to add cost because they got to figure out a different way to get the product in the customers' hands, we don't.

We use the exact same infrastructure, the exact same – the stores do the final mile. They do any returns. They manage the account going forward. So we don't have to add any expenses. If anything, our expenses have come down. We took the opportunity, not knowing – with all the uncertainty in March, we took the opportunity to take yet another look at our expenses and took even more expense out of the business.

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

A

Yeah. We've also been able to shift some of what had traditionally been a fixed cost structure with labor in our stores and essentially a fixed cost structure and, especially with the stay-at-home orders, been able to change it to be a more variable cost structure. We were able to make some changes to labor, the labor model, and some of those will remain in place going forward.

We've also found more efficient opportunities to take advantage of the centralized collection centers that we inherited through the acquisition of Merchants Preferred. And again, some of these improvements will remain with us after the pandemic and will make us better positioned to improve margins going forward, especially in the Preferred Lease business. There's a number of changes that we've been able to make that will improve margins over time, not just from what we've been talking about, scaling that business up, which will definitely increase margins, but also improve some of the structural changes that we've made because of the pandemic.

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

Q

And, Maureen, that's helpful and then sort of staying in that conversation, late March, early April was pretty scary. We didn't really know precisely where it was going to go, although I think you guys were a little more levelheaded than many, but it did cause expense reductions. And so, yeah, I guess the question I have is, to the extent revenue comes back faster than you think, do expenses sort of lag that, and does it provide both maybe a near-term and a more permanent maybe term margin expansion opportunity?

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

A

Well, in the third quarter, there will be some impact on the top line because of the portfolio when we were shut down, the lower demand that we experienced during that timeframe, but we have brought back a lot of the coworkers that were furloughed in anticipation that – to fulfill our strong demand that we have right now and expect that we'll continuously bring back expenses.

So, as we've mentioned in the last call, the third quarter is typically the lowest quarter and may have some cost pressure as we bring back the costs relative to the second quarter. But the good news is we have plenty of demand, and so we've brought back the coworkers to be able to fulfill that demand. And so, to answer your question about margins, I think we were able to offset the declines of the second quarter by reducing the cost.

You saw the directional guide that we gave that revenue would be less than 10% impact and EBITDA would also be in that range, which shows you about a $30 million decrease in costs in the second quarter. However, we'll be bringing that back in the third quarter, so there could be some margin impact there. But we felt like it was [indiscernible] (00:27:05) and are trying to match the expenses with the revenue as much as we can.

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

A

But in the long run though, and you mentioned it, you mentioned it, Maureen, on Preferred Lease side, some of the things we're doing as we reopen do have long-term margin positive impact so.

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

A

Right.

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

A

So, yeah, John, I think the second quarter is the best scenario where you're going to be down in revenue versus last year of 10% or less. It's the same with EBITDA, which we thought was pretty impressive to have the same percentage difference in revenue and in EBITDA. But in the long term, there' still going to be some benefits as we figure out some different efficiencies through coronavirus.

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

Q

Okay. So you don't talk about balance on rent anymore or the lease portfolio. But, obviously, there's been degradation in that in Q2, so that is somewhat of a lagged impact of revenues as we go into the back half and then your costs come back. But structurally longer term, there may be some more margin opportunities, is that the way to maybe think about it?

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

A

That's right.

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

A

Yes, yes. So, when you think about that degradation in the portfolio, remember the vast majority of that would be on the Preferred Lease side because those weren't essential businesses and a lot of them were fully closed, like I said, 75%, 80% at its peak. So, whereas on the brick-and-mortar side, the demand has been – and fortunately for us, that's the bigger side of our business right now so a little bit of degradation in the third quarter.

And you see it in the estimates that are out there from the second quarter to the third quarter. And of course, it's always the seasonally lowest quarter. So it's not that much off based on the estimates that are out there. But in the long term, yeah, we've learned some efficiencies here that can really help us.

John Allen Baugh

Analyst, Stifel, Nicolaus & Co., Inc.

Okay. Super. Okay. I think we are about out of time. And so, I wanted to again personally thank you both, Maureen and Mitch, for taking the time and chatting with us today, and thanks to those participants on the line, and we look forward to a good June quarter print and following up with you thereafter. Thanks again.

Mitchell E. Fadel

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

Well, thanks, John, and thanks, everybody, for listening and sending in some questions. And any follow-up questions, we'd be happy to do one-on-ones with anybody else on the call that has follow-up questions. Thanks, everybody.

Maureen B. Short

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

Thank you.