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Rent-A-Center, Inc. (RCII)

Q1 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

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

As a reminder, this conference is being recorded, Thursday, May 7, 2020. Your speakers today are Mitch Fadel, Chief Executive Officer of Rent-A-Center; Maureen Short, Chief Financial Officer; and Daniel O'Rourke, Senior Vice President of Finance and Real Estate.

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

Daniel O'Rourke

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

Thank you. Good morning, everyone, and thank you for joining us.

Our earnings release was distributed after market close yesterday, and it outlines our operational and financial results for the first quarter of 2020. All related materials, including a link to the live webcast, are available on our website at investor.rentacenter.com.

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

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

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

Mitchell E. Fadel

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

Thank you, Daniel, and good morning, everyone. Thank you for joining us.

We will be providing a voiceover to the presentation shown on the webcast, or it can also be found at investor.rentacenter.com.

So, starting on slide 3, the coronaviruses has put significant stress on our economy. And on our organizations, we all adjust to social distancing and other governmental measures to combat the pandemic. We've worked extremely hard to ensure the health and safety of our employees, customers and suppliers, which is our number one priority, while making sure we're addressing our customers' needs. Many are affected by this crisis. We are sensitive to their condition and focused – and reinforcing the attributes that have made Rent-A-Center a trusted partner for over three decades.

The responses highlighted the strength of our organization. Our people have gone above and beyond in so many ways, from providing masks, to keeping everyone safe, to implementing curbside pick-up, and keeping the increased volume of e-commerce deliveries moving smoothly. Their hard work and dedication, especially of our frontline co-workers, inspire each of us every day, and I'm incredibly proud of their efforts.

The responses also underscore the relative strength of our lease-to-own model all versus traditional retail. It was the case in the great recession when lease-to-own sales outpaced general retail, and it's proving to be the case in the current economic environment. While this situation continues to play out, our metrics thus far are performing better than we initially expected when this pandemic started. April was a solid month, helped by government stimulus and e-commerce increases. Financial stress is not new to our customers, and the slowdown appears to be having a more substantial impact for retailers outside the lease-to-own channel we serve.

Our model is unique and then it features a revenue stream from lease payments. It also has low loss rates as customers generally return product if they can no longer make payments, which we then re-rent. As a result, even though revenue has been impacted slightly by a small portion of showroom closures, we continue to generate recurring revenue, and demand for essential products such as appliances and computers has been strong.

Turning to slide 4, digging in a little deeper in the revenue performance and what's happening in our stores. The first quarter marked the ninth consecutive quarter of positive same store sales in the Rent-A-Center Business, and our growth is still on the high-single-digits at over 7% from a two-year perspective. And since the beginning of the pandemic, almost all of our Rent-A-Center stores have remained opened to address needs-based activity from our credit constrained customers.

While most remained fully open at the peak, about 25% of our locations were operating with a closed showroom. That's come down about 19% as state and local governments move reopen their economies. We have strived operating compliance with applicable local, state and CDC guidelines, and we're well-prepared to move forward with further showroom openings as areas allow.

We also operate in retail partners through our Preferred Lease segment, where we continue to see strong invoice volume versus last year of 17%. Though many of those stores were closed during the second half of March, we benefited from the recurring revenue nature of our lease agreements. About 65% of our staff locations are now up and running in retail partners with open stores, and that compares to only about 25% at the end of March. Our virtual channels saw a dip in applications in March and April, but the demand is turning back towards normal levels. Preferred Lease is an important strategic business for us, but it's not yet a substantial portion of our business. So, the impact to our overall operating results has been muted, but really pleased by payment activity in the segment. And as those retail stores reopen, we're seeing strong demand for our lease-to-own program.

Sales for the quarter increased modestly, driven by the same store sales increase of 1.7% in the Rent-A-Center Business and the addition to the Merchants Preferred virtual solution. We're encouraged by trends we're seeing in e-commerce, which experienced growth of over 100% in April versus last year.

First quarter adjusted EBITDA remain consistent with the first quarter of 2019, while non-GAAP earnings per share grew by almost 15%. There will be an impact from the pandemic in the second quarter as it compares to last year, but we believe it will not be near as severe as traditional retail, as we expect our level of decline to be 10% or less with the potential for a lower impact on EBITDA.

Turning to slide 5. We're committed to investing in strategic priorities that we believe have the potential to steepen our long-term demand curve by improving the customer experience. E-commerce is clearly one of those. We responded to the widespread social distancing by accelerating initiatives to enhance customer service, add new payment options for unbanked customers, and implement additional e-commerce functionality. These initiatives are improving traction with both new and existing customers. In addition to our digital strategies, overall demand is being helped by the government stimulus and our own internal programs. The majority of our customers qualify for the US CARES Act and many of these stimulus funds to make rental payments. In fact, the day that direct deposit government stimulus payments were sent out, we saw a material increase in demand in revenue. And we expect further benefits from stimulus as the mail checks go out in waves all summer.

We also offer an internal program called Benefits Plus, which includes an unemployment benefit, underwritten by Aeon that enables eligible customers to become unemployed to keep their merchandise during this difficult time, which is providing nice additional support. [indiscernible] (00:07:47) each of the segments performed in line with expectations for the quarter. Most of our products are necessities that our customers want to keep, and we're working to help them do just that, even providing payment extensions in some cases.

In addition to adding digital capability to support demand, we are making continued progress to streamline operations. And I want to stress that these initiatives are really paying off. We've been able to react faster and work smarter, and that's helped offset some of the near-term headwinds from the response of the virus.

Importantly, the focus on optimizing cost will have long-term benefits as well. Here's just one example, we made enhancements to our centralized contact center as we reduced labor hours in the staffed Preferred Lease stores. We believe there is a long-term opportunity to become more efficient at collections as we free up store hours to support additional sales.

Our financial condition is strong with substantial liquidity as we move forward on our strategic plan. We ended the quarter with $183 million in cash and no debt maturities until 2024, and we've prioritized our cash for operations. We are expecting sequential improvement in cash flow in the second quarter and are continuing to invest in our strategic priorities. We've also declared our second quarter dividend consistent with historical amounts.

Based on our experience during the great recession, we expect demand for our products and services to continue to increase as prime and subprime lenders move back up the credit scale. The demand increases we've historically seen at the top of our funnel typically more than make up for any short-term impact we see during recessions. We've put a lot of time and effort in improving the customer experience, and we're confident in our ability to execute on our strategic initiatives to capture whitespace opportunity via digital and virtual.

We see numerous opportunities to gain market share in the Rent-A-Center segment, and we also believe that the stress on traditional retailers is enhancing our growth prospects for Preferred Lease. Our conversations with potential retails partners show that they are looking for ways to improve their sales as the virus accelerates change. We have a strong balance sheet and a flexible partner model versus competitors that are not as well-capitalized, particularly at the regional level, really some great opportunities for us there.

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

Maureen B. Short

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

Thanks, Mitch.

As you can see on slide 6, consolidated earnings were favorable to last year, with an increase in the top line and a slight decline in the adjusted EBITDA margin. Consolidated total revenues were approximately $702 million in the first quarter, an increase of 0.8% versus the same period last year. The gain was driven by the addition of the Merchants Preferred virtual solution and a same store sales increase of 1.7% in the Rent-A-Center Business, partially offset by refranchising and rationalizing our store base.

Adjusted EBITDA was $65.5 million in the quarter, and adjusted EBITDA margin was 9.3% versus 9.5% in the same period last year. Non-GAAP diluted EPS was $0.67, up 14.6% over last year. Other benefits to non-GAAP diluted EPS included lower interest expense versus last year and a lower tax rate of 18.4%, down from 22.9% in the first quarter of 2019.

Turning to segment results, starting with our largest segment. Revenues for the Rent-A-Center Business, which includes corporate-owned US stores and rentacenter.com, were $455 million in the first quarter and benefited from a 1.7% increase in same store sales. To provide some context for the coronavirus impact, same store sales in our Rent-A-Center Business increased 2.8% in January, 4.8% in February, and were down 2.5% in March since the initial impact of the pandemic took effect across the US. In April, trends improved sequentially, driven by government stimulus payments.

Adjusted EBITDA for the Rent-A-Center Business was $74.5 million, up 240 basis points as a percentage of segment revenue versus the same quarter last year. The performance was driven by better gross margin and lower operating expenses as we continue to streamline the business. As a percentage of revenues, skip/stolen losses for the Rent-A-Center Business were 3.9%, a 20 basis point decline from the fourth quarter of 2019 and up 20 basis points versus the year-ago period.

Preferred Lease total revenues increased 10% in the first quarter versus the same quarter last year. The performance reflects a 17% increase in invoice volumes, driven by the addition of the Merchants Preferred virtual solution. Adjusted EBITDA for Preferred Lease was $18.8 million or 8.7% of revenues. The year-over-year change in EBITDA as a percentage of sales was driven by investments to support future growth, the mix shift to virtual locations, and the impact from the coronavirus from closed retail partner locations during the second half of March. Skip/stolen losses were 12.2% of sales for the Preferred Lease segment in the first quarter, up versus last year before we increased our mix of virtual locations, but down 200 basis points sequentially. Profitability in the segment is expected to improve as we scale the virtual offering.

Finally, on the Corporate segment, first quarter expenses increased $5.5 million, driven by the addition of the Merchants Preferred virtual solutions, rent expenses resulting from the sale and partial leaseback of the corporate headquarters, and timing of our annual stock award grants.

Moving on to the balance sheet and cash flow highlights, cash generated from operating activities was $47.4 million for the first quarter. The company ended the first quarter with $182.9 million of cash and cash equivalents and outstanding indebtedness of $362 million.

Now, turning to slide 7. As we outlined in our March update, we are not providing guidance for the year given the fluid nature of the coronavirus and the varied efforts by the states to contain the spread and reopen our economy. That said, we do want to provide additional color on our near-term outlook and the adjustments we're making to address these challenges. There will be an impact overall in the second quarter as it compares to last year, but not as severe as many traditional retailers are experiencing. Based on what we know today, we expect second quarter revenue to be down 10% or less versus last year, driven by lower demand from closed locations and lower collections.

As Mitch noted, we have transformed the organization to incorporate a more variable expense structure. And we expect that, coupled with our ongoing focus on reducing cost, to result in an EBITDA decline for the second quarter in the same range to slightly better than the impact in revenue.

Additionally, given the improved capital structure and lower interest expense versus last year, earnings per share is expected to be essentially flat to last year during the second quarter. We do not expect to see material pressure on skip/stolen losses for the year. As you know, our contracts are leases and, unlike a traditional subprime lender, returning the merchandise is always an option for our customers. Additionally, any pressure we do see on skip/stolen losses is reflected as a noncash write-off of inventory when customers stop paying and do not return the merchandise.

Turning to expenses. We've made a number of additional adjustment to reduce operating expenses, including executive pay reductions, temporarily furloughing employees in stores and at our corporate office, reducing stores hours in some cases and where possible renegotiating real estate leases. We plan to bill back in some expenses as we move into the second half of the year, which has the potential to impact our seasonally low third quarter. That said, we believe our actions will further streamline costs and improve efficiency, benefiting future years.

Regarding cash flow, inventory purchases and capital expenditures have been reduced in order to partially mitigate the impact of the coronavirus. In addition, we were able to take advantage of the net operating loss carryback in deferred payroll taxes available as a result of the CARES Act. We are tracking to a sequential improvement in free cash flow as compared to the first quarter 2019. Our near-term outlook of down 10% or less in revenue and EBITDA for the second quarter reflects the resiliency of our lease-to-own model and our swift actions to reduce cost.

Turning to slide 8. Our financial position is strong, with total liquidity of over $230 million, and net debt to adjusted EBITDA up 0.7 times at the end of the first quarter compared to 1.4 times in the year-ago quarter.

Our liquidity at the end of April is actually up to $280 million, an increase of approximately $50 million since the end of the quarter, driven by strong performance in April. Our capital allocation priorities are to continue to invest in the business and return value to shareholders. In the first quarter, we increased our quarterly dividend from $0.25 to $0.29 and repurchased 1.46 million shares for $26.5 million, returning approximately $42 million in capital to shareholders. As Mitch mentioned earlier and given our healthy financial position, we intend to pay our second quarter dividend on June 1.

As always, detailed income statements by segment are posted to our Investor Relations website, and we anticipate filing the 10-Q on May 11.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And your first question will be from the line of Bobby Griffin with Raymond James.

Robert Griffin
Analyst, Raymond James & Associates, Inc.

Q

Good morning, everybody. Thank you for taking my questions. I hope everybody is doing well and staying healthy. I guess, the first question I want to ask Mitch and Maureen is around the portfolio nature of the business. Given that trends are starting to improve here in April and more states are opening, will 2Q largely be on the low watermark for revenue, or does the portfolio side of the business mean that the impact could actually be worse in 3Q from a revenue decline perspective? Just trying to understand how this business will kind of trend going forward, if we stay on the same path of more opening than modestly sequentially improving trends by month.

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

A

Yeah. Good morning, Bobby. I think at this point, it's too hard to say what's going to happen in the portfolio between now and in the end of the quarter, which is what'll drive the third quarter revenue. So, I don't know if it's the low watermark or not; there's really too much – it's too hard to forecast. All we can tell you is demand is really strong right now. As you can see, April was good, demand was strong. But where the portfolio will end, I don't know, we can't predict the third quarter yet to say that the second quarter is at the low watermark or not.

Robert Griffin
Analyst, Raymond James & Associates, Inc.

Q

[indiscernible] (00:21:07) maybe ask it a different way. If based on the guidance of down 10% for 2Q revenue, are you assuming that contracts written into the portfolio modestly improve in May and June versus what they're doing today in April?

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

A

Well, we expect the demand to stay strong for a couple of reasons. The stimulus is still going, there's paper checks getting mailed out all summer long. So, we expect that to continue to help the, yeah, tightening credit as we've talked about that we're already seeing in the marketplace as credit tightens up, it pushes more demand in the lease-to-own transactions. So, we expect demand to be – to continue to be strong not just in April, not just an April thing.

Robert Griffin
Analyst, Raymond James & Associates, Inc.

Q

Okay. And then I guess, lastly for me, you mentioned it briefly there in your response. But when you talk to kind of your third-party retail partners and you look at kind of the pipeline for Preferred Leasing, are they starting to mention already that the first tier and second tier offerings that they usually use for credit are changing, and you're seeing more people either new customers or current customers having to rely on that rent-to-own offering? Or is that typically three, six months that happens three, six months after we get a economic shock like we're getting now? How quick does that credit conditions typically change?

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

A

We think it's happening already. And it's not just from anecdotal feedback from retail partners, it's – I mean, we see and we have a decision engine in the Preferred Lease business. So, we see the customer that gets – that comes into the engine from a credit standpoint, not necessarily FICO score standpoint but our own credit decisioning, both in staff's locations and in virtual locations. And we're seeing a higher quality credit customer coming into the decision engine already.

Robert Griffin
Analyst, Raymond James & Associates, Inc.

Q

Okay. I appreciate that. Those both are very helpful. I'll jump back in the queue. Thank you for answering my questions.

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

A

Thanks, Bobby.

Operator: And your next question will be from John Baugh with Stifel.

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

Q

Good morning, and congratulations on a great first quarter on a tough environment. I'll jump right in. Any comment, Mitch, on what's happening with pickups? Obviously, yours skips-off and stolens are in good shape. And I'm curious, are you having to pick up and then re-rent much more frequently today?

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

A

No, we haven't seen that yet, John. We're working with customers. They want to keep our products [ph] like we are somewhat (00:24:05) the majority of our products are essential products. The customers want to keep them. The customers not necessarily under any more pressure than they normally are. I mean, I think as you know, those customers are under pressure all the time. This, obviously, is a tough time for a lot of people. But I don't know that if it's necessarily more specific to our customer than maybe others. Keep in mind, the majority of the essential workforce probably fits in our customer demo, so we're not seeing anything dramatic there.

And the people that need help, we're working with them, they keep it on rent. We haven't been in the field a whole lot the last six weeks either. Will there be a few more pickups in May and June than normal? We haven't seen it yet. I think there probably will be a few more, which on one hand is okay, because we buy less products that way to re-rent to others because the demand. The comfortable thing the demand will outrun any return in the pickups as more and more people get pushed into the lease-to-own transaction as credit tightens, as people are looking for more flexible options and so forth.

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

Q

And then, you mentioned the Aeon benefits. Could you just sort of review, for my benefit and others, how many customers have that? I assume that's on the store side. And how that's kind of working? What you're seeing, how many people are utilizing that benefit now? And kind of how the pluses and minuses of that are working so far?

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

A

Well, it's all pluses. About 70% of our customers have agreements that have the Benefits Plus attached to their agreement, which includes the unemployment benefit like I said, underwritten by Aeon, and which allows eligible customers who become unemployed to keep their merchandise. I would tell you that we've – it certainly gone up from normal circumstances, but it's not an avalanche of claims for that. I really think we're seeing it's not like – I'm not seeing an unemployment rate at our demographic higher than what maybe is impacting middle income or higher incomes. Again, I think the majority of the essential workforce out there is in our demo.

So, it's helpful. We're glad we have it. We make money when we sell the product. And now, it comes in handy. And Aeon's processing the claims. It has more claims than normal, of course. But it's not – it's a nice support. I mean, it will help us $1 million or $2 million a month in money coming in from someone like Aeon, and helps the customers keep the product because they make the payments for them. But it's not like it's going to be 20% of the revenue or anything like that, no. We're just not seeing those kind of unemployment rates with our customers. It's up. I can't say the exact number. I don't know what the exact number is, but it's not.

I think there's an impression of it that it's the lowest income has got to be hurt the worst, and I don't know if that's the case. Obviously, time will tell. But like I said, I think the majority of the essential workforce that's working in this country right now is our customer. So, if it certainly helps them, we're glad we have it.

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

Q

Staying on this theme, you mentioned the payment extensions in some cases. Correct me, if I'm wrong but you do that to some degree all the time. So, the question is are you doing it meaningfully more? Or to the comments you just made, no, it's not that bad, slightly more, what are you seeing there?

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

A

Yeah. More the latter. I'd say, a little more than slightly. But it's not – again, it's not an avalanche of having to do that. We'll do it to help the customer keep the product. But it's a circumstance by circumstance decision that the stores make. And for Preferred Lease, our contact center makes. It's up, but it's not. You see, we're forecasting the revenue to be in the second quarter less than 10% drop from last year. So, it's obviously not a huge number. Because if we do the expansion...

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

Q

[ph] And how about... (00:28:54)

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

A

It's not like that would count towards the revenue if we do the expansion. If it was that big, that our revenue forecast for the second quarter would be worse than what we're telling you.

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

Q

Correct. Okay. And then, you mentioned on the Preferred Lease side that, I think, the 25% on your customers or your retail partners were closed at the end of March. And 65%, I think, were open now, and you're "trending toward normal." I guess, kind of two-part question. Most of those retail partners are furniture, if I recall correctly. And I would assume, even if they're open now, their business is still off substantially versus pre-virus being opened. So, I'm wondering, turning back towards normal sounds like you're close to getting it all back. I just find that a little hard to believe. But what are your expectations on that business revenue tracking? And I assume we'll get most the stores open within the next 60 days, if not sooner.

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

A

Yeah. And the numbers we [indiscernible] (00:30:11) the prepared comments, John. Only 25% – at the end of March, only 25% were open; and now, it's 65%. So, the inverse of that, obviously, 75% closed and only 25% opened at the end of March; now, 65% are open. So, – and I agree with you. I think by the end of the quarter if not sooner, it will all be open.

I think we've been pleasantly surprised even in the furniture categories that the demand has been strong. I think furniture retailers will tell you – because I talk to a lot of them, will tell you they've been surprised that, initially back in the middle of March, the rush was essential products, like computers and appliances and so forth. And the longer people are in their homes, I think, what we're seeing – and as I said, in talking to some furniture executives, CEOs and some of the bigger furniture companies, the belief is now based on what they're seeing is that anything for the home is going to do well. Anything. As people are inside more and staying home more, and not only through the pandemic but even afterwards, there's a belief people will be home more and out to eat less and those kind of things as you know. But it seems like anything for the home, the demand is high.

And I'm not saying that furniture executives will tell you they're doing better than last year. But what they thought they would do when they reopened compared to what they're doing is doing a lot better than they thought. But there is a lot of pent up demand there. And a lot of the stores are opening and we're getting back to normal levels ourselves.

So, keep in mind, John, they could be 20% off last year and we could still be doing more as credit above us tightens up. So, I think in a furniture store, because of social distancing and so forth, they are still going to be down some. Not as bad as people thought when this started; when they reopened, they're not down as much as they thought they were. And we may not be down at all based on credit being tighter above us.

Operator: Okay. Your next question is from the line of Brad Thomas with KeyBanc Capital. Please, go ahead.

Bradley Thomas
Analyst, KeyBanc Capital Markets, Inc.

Q

Hi. Good morning, Mitch. Good morning, Maureen. And let me have my congratulations on some nice execution here of late. Let's see here. I wanted to just follow up on some of John's questions on the direct side of the business. I apologize if I missed it, I'm having trouble getting the slide deck up. But can you talk a little bit more about what the invoice volume growth rates, what those trends have looked like as you went through March and April, and how it's tracking here in early May?

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

Well, the 17% increase in the invoice volume on Preferred Lease in the first quarter. And we pretty much lost the last two weeks of March. It was very, very low those last two weeks of March, with 75% of the stores closed. So, if you factor in those two weeks or about 15% of the quarter, I mean, that 17% gets back to where we were like in the fourth quarter, in that 30% range, if we hadn't lost those last two weeks. So – and as I said, as they reopened, the demand is strong. I don't have a forecast for you on what we think the invoice volume will be in this quarter. But as you see, we expect it to be pretty strong based on the kind of revenue that we're forecasting for the quarter.

Bradley Thomas
Analyst, KeyBanc Capital Markets, Inc.
Q

Got you. Okay. And can you remind us how much Merchants Preferred would have contributed to revenue and invoice volume here for the quarter as being an acquisition?

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

Yeah. Revenue in the quarter for Preferred Lease was $23 million. And it generated invoice volume pretty similar to what they contributed last quarter, around the same range as the revenue number for the quarter.

Bradley Thomas
Analyst, KeyBanc Capital Markets, Inc.
Q

Okay. Great. And then I guess, Mitch, in terms of a bigger-picture question here. As you think about the Rent-A-Center side of the business and the Preferred Lease side of the business, how does the new world that we're in, how does it change strategically? How would you like to position these businesses as you think about the strategy and some of the investments you're going to be making over the next couple of years?

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

I think it's – yeah, so much more the business is going towards the web e-com. And we're – as we said, we're double in April where we were a year ago as far as orders coming in on the web. And we wouldn't expect it to stay at double, but we would expect it to stay high. And we think more – this isn't going to be a one and done thing. As far as more people shopping online, it's going to continue. Well, we're making investments in it.

One of the – maybe one of the most telling stats that I can give you, Brad, is when we say April was double, about two-thirds of the customers, they come through our website and e-com site and put their – put an order in through our e-com site, about two-thirds of them are new customers that we haven't seen do business with us before or at least not in a very long time. And the two-thirds new customers is holding as the numbers doubled from last year. So, not only is the website, the e-com business doubled; the two-thirds being brand-new customers has held. So, that new customers has doubled, too. And I think that's a way of telling stat. And we'll continue to invest there.

And I think that's partially because of our value propositions, it's partially because our credit tightening up above us. Flexibility, the fact that this is a lease and not a sale, all those kind of things. And so, we'll continued to invest there. We've added additional payment options for the customer, both banked and the unbanked customers, so they can pay in multiple places. We've made it easier to sign up for autopay. We've added texting capabilities, both on the sales and the collections side. So, a lot of investment on the e-com side. And that's what we say, well, we're going to come out of this stronger.

And so, from a strategic standpoint, whether you're talking about Preferred Lease or Rent-A-Center, e-com is probably the biggest change from a – not that that wasn't part of the strategy, but it just got a lot more important. And a lot more of our investments going there and we're – we just couldn't be more thrilled with the fact that it is doubling in April and through the first few days of May, and that the two-thirds of new customers has held. So, it's not like our customers are just sitting home using our website to do business with us instead of coming to the store because of the are stay-at-home orders; the new customer portion of it has doubled as well. And I think that says a lot about our brand and says a lot about our value proposition.

Bradley Thomas
Analyst, KeyBanc Capital Markets, Inc.

Q

Great. That's very helpful. Thank you, Mitch.

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

A

Thanks, Brad.

Operator: Thank you. And your next question will come from the line of John Rowan with Janney. Please, go ahead with your question. [Operator Instructions]

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

A

Maybe on mute, John.

Operator: His line is open now.

John Rowan
Analyst, Janney Montgomery Scott LLC

Q

Hi. Can you hear me now?

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

A

Yes. Hi, John.

John Rowan
Analyst, Janney Montgomery Scott LLC

Q

Hi, guys. Good morning. So, as you look into 2Q and you made the comments about having a big increase in cash flow, what are your plans? Are you going to maintain a high level of liquidity and a lot of cash, or would you look to actually reduce debt in 2Q?

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

Yeah. So, we're evaluating that. We initially drew down an additional $118 million when the pandemic first started, because of the uncertainty and just to make sure that we had access to our cash flow and adequate liquidity. Given the increases in cash flow that we're expecting in the second quarter, we'll be evaluating that. We'll know a lot more about the state governments opening up their economies and what impact that's going to have on our business, and may feel comfortable at some point within the quarters soon after to reduce that debt.

John Rowan
Analyst, Janney Montgomery Scott LLC
Q

Okay. And then, can you remind me, is there any online-only business in Merchants Preferred, meaning that you don't actually – that the merchandise you shop for online and then lease on transaction is created fully online? Or is it primarily the virtual lease-to-own in-store?

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

Well, it's a combination. We don't yet have any retailers that only do businesses online. But in our – generally speaking, in Preferred Lease, about 30% of the business [audio gap] (00:40:15) location starts online with that retailer. So, it's about 30% of that business, like I said. But it's not 100% anywhere where they don't – not doing business with anybody yet that doesn't have any stores.

John Rowan
Analyst, Janney Montgomery Scott LLC
Q

Okay. Thank you.

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

Thank you.

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

Thanks, John.

Operator: Okay. Your next question will come from the line of Kyle Joseph with Jefferies.

Kyle Joseph
Analyst, Jefferies LLC
Q

Hey. Good morning, guys. Thanks for taking my questions. And apologies, I hopped on late, if I do ask something that was stated earlier. I just wanted to get a sense. You guys have given us a lot of color on Preferred Lease, but I kind of want to cover retail demand for the virtual rent-to-own product. Have you seen an increase in inbound calls from retailers looking to add the virtual rent-to-own to their product suite?

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

Yeah. It's pretty active there. As the retail goes through the such – and I don't know what you want to call it – such a huge change, so fast and accelerated change, if you will, we think there's going to be great opportunity for us to add accounts, large accounts and small accounts for that matter. And we think there's going to be a huge opportunity as they look for ways to replace tightening credit, primarily. And so, we think it's going to be a better environment coming out of here for the Preferred Lease business than even before.

Kyle Joseph
Analyst, Jefferies LLC

Q

Got it. And then, just it'd be helpful if we get a sense for your thoughts on the health of the underlying consumer. Obviously, we've had unemployment claims go up a lot, but we've had stimulus and federal unemployment to offset that. Obviously, that's scheduled to end at some point. But can you just walk us through where your customer is right now in general, and where you see that heading over the next, call it, months and quarters?

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

A

Well, I think the customers is in pretty good shape right now. With the stimulus, they have got more disposable income. We're seeing demand at really strong levels. As I've said a couple of times this morning, Kyle, our customers are under pressure all the time. So, what we've seen in past recessions is more customers get pushed, come into the top of our funnel as credit tightens. And to the extent, there's any that we move out of the other side of the funnel that we can't keep on rent that struggle too hard. We've seen in the past is, more customers get pushed into our transaction than get pushed out of the transaction during a recession.

And when you think about our e-com business being double what it was a year ago, and our new customers coming as part of that number also doubling, I'd say there's a lot of customers getting pushed into the transaction. And it's kind of under the belief it's going to be like past recessions where we do pretty darn well.

Kyle Joseph
Analyst, Jefferies LLC

Q

Got it. And then, given this environment and the shift to e-commerce, can you give us a sense for how sales have – the mix shift has shifted and impacts on margins? The margin at the Rent-A-Center Business was much better than I had modeled for it, and I believe that's year-over-year. So, can you give us a sense for your outlook there?

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

A

Yeah. The margins probably, they are pretty good in the Rent-A-Center Business, probably just because of the changes we made to the value proposition. It is not necessarily because of shift in product mix. Certainly, when this started, there was more push on the essential products. Laptops were hot, appliances, refrigerators and freezers and the like. Even game consoles as people at home were, I guess, trying to give their kids something to do. Or maybe, it's more adult these days. I don't know, I'm not a gamer. But we were rented off a lot of game consoles.

And but as we – six weeks into it now, the mix is getting pretty even. The furniture is starting to move again, and moving well with good demand. And TVs are going again. And I think right now, it's spread out over all of our products as the – as people stay at home more, it's not just the things they had to have real quick, like a laptop to work from home or for the kids because they're homeschooling and so forth. It's pretty well spread out through all of our product categories now.

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

A

And the mix of e-commerce sales as a percentage of revenue was 16.5% in the quarter, which was up from 14.7% in the fourth quarter of 2019. So, we continue to see that increase. And then, of course, with some of the closed showrooms and some of the shift in customer behavior to shop online, we saw an even more dramatic increase this past quarter.

Kyle Joseph
Analyst, Jefferies LLC

Q

Got it. That's really helpful. One last one for me. Just highlight your outlook for the second quarter is very impressive in this environment. Obviously, you guys had rents coming down to a certain extent. But in terms of modeling, what line items in terms of expenses should we expect to be the big offsets there?

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

A

Yeah. A lot of the savings on the operating expense side come from temporarily furloughing store employees. Where there is cases of closed showrooms or, with Preferred Lease, the retail partner is closed, we've temporarily furloughed our employees. There is also decreases that we're seeing in real estate costs. We've renegotiated leases, with a pretty significant number of our landlord taking either rent deferrals or even rent reductions. And then, there is – we did evaluate any nonessential type of spend as to try to counteract some of the negative impacts that we're seeing from the top line. We will see a modest increase in skip/stolen losses in the second quarter. However, we're doing everything we can to try to offset those losses by being smarter about our costs and reducing costs where we can.

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

A

So, this, and the biggest line – to summarize what you just said, Maureen – would be the labor line.

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

If you're – the reason that the revenue's down less 10% and EBITDA is down less than 10% as well, it will be down less than 10% as we forecasted today. Labor is the biggest line you would be adjusting in a model, right?

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

A

Right. There's others that are more variable expenses. Like for example, we're doing less deliveries, less pickups. And so, there is – the delivery cost is lower.

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

A

Well, gas – and gas prices...

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

A

Gas prices are down.

[indiscernible] (00:48:03)

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

A

So, that helps drive it...

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

A

Yeah.

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

A

...and any other variable type of expenses will be lower in that quarter.

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

A

Yeah. Kyle, we – for a lot of years, people thought of us and we even said we had a real – a more fixed cost model. And we really, over the last couple of years in having the turnaround the company a few years ago, we really turned our labor model into something what you'd call it a variable model now. And we don't have any of the minimums, so like you got to have a minimum of this number of people, and so you got a minimum of this number of trucks. And it's very much variable now. And as some showrooms are closed or as demand was soft before the stimulus checks came out, then we were able to reduce the labor. So, the labor is a variable line for us now as compared to what it has been in the past.

Kyle Joseph
Analyst, Jefferies LLC

Q

Really appreciate that. Very helpful. Mitch, Maureen, thanks so much. And echo others on congrats on a great quarter despite the rough operating environment.

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

A

Thanks, Kyle.

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

A

Thanks, Kyle.

Operator: Your next question will come from the line of Vincent Caintic with Stephens. Please, go ahead.

Vincent Caintic
Analyst, Stephens, Inc.

Q

Hey. Thanks, guys. Good morning. Appreciate the guidance you gave for the second quarter, and that it's a very strong guidance, appreciate that. Could you possibly help break it out by segment level, so how you're thinking about the Rent-A-Center stores versus Preferred Lease for revenues and earnings?

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

Yeah. So, we do expect to see a top line impact that's fairly similar between the two segments. But from an operating expense standpoint, as we did walk through, there is a number of more items that we can address on the Rent-A-Center side to help offset some of the impacts; versus the Preferred Lease side where we've seen more of the closures and more of that impact without as many opportunities to address the expense side.

We have looked at reducing the labor lines within the Preferred Lease segment as well, and has done temporary furloughing of employees. We've also shifted some of the collections activities to our centralized call center to try to improve the efficiency and help improve the margin. But we will see more of the pressure on the skip/stolen losses in the Preferred Lease segment; versus the Rent-A-Center Business where we're able to pick up the product, we have more of a relationship with the customer. And should see very modest impact on skip/stolen losses within the Rent-A-Center business.

Vincent Caintic
Analyst, Stephens, Inc.
Q

Okay. That's a very helpful detail. Thank you. And I guess, on that, when I think about the skip/stolens and bad debt, and also how you think about maybe depreciation of the items, any thoughts on incremental, say, reserves that you'd have to take bear? And I guess, maybe one related question, but does the new CECL accounting methodology affect your accounting at all?

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

The CECL impact was only experienced in our installment sales, Get It Now! and Home Choice business. That was less than a $1 million and did not affect our Rent-A-Center or Preferred Lease businesses.

And the skip/stolen losses that we talked about in the first quarter, we did look at the reserves and did take some adjustments where needed. But not a significant adjustment made for COVID-19. We'll see reserve adjustments likely in the second quarter to address potential pressure in skip/stolen losses.

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

But anything we think we might need to take in the second quarter is built into the fact that we still think EBITDA will be within...

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

...10% of last year. And total EPS of, when you factor in the interest savings, it'll be pretty flat with last year. So, it's not going to be a huge number. There's other offsets.

I'll just remind everybody that this is still a lease and not a sale. I mean, when things get tight, people can just return it. We can re-rent to somebody else. And we work at our customers to keep them on a rent. But this isn't a subprime loan where if they don't have the money, there's nothing much to do but write it off, write off the balance. So, it's a much more flexible business model in lease-to-own and we've seen that. You can go back and look at 2008 and 2009 losses, and they're just not there.

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

A

Right. And if they are write-offs, they're inventory write-downs; they're not cash impacting items.

And then, one other thing to point out. We have seen some pressure on collections, but that's already reflected in our revenue numbers since we don't record the revenue until we collect payments from our customer. So, that's already impacting our business and is reflected in our color about the second quarter, with revenue and EBITDA being down 10% or less. Those are reflected with the lower collections, our estimates for what the skip/stolen losses and reserves will look like. And we still believe that we can perform with pretty decent margins given this environment.

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

A

And I think, Vince, all of that reflects on the operations team in both Rent-A-Center and the Preferred Lease side what a great job they're doing; not just management, but even more specifically our frontline store coworkers, of what a great job they're doing during these trying times to help the customer get new products as well as help keep people on rent. We got additional ways for customers to pay than we had just six weeks to go as far as payments online and so forth. So, there's been really a great team effort on making it easier for the customer to pay and a great effort by our store employees.

Vincent Caintic
Analyst, Stephens, Inc.

Q

Right. Yeah, it definitely shows in your results. Appreciate that. I guess, last question. So, on the topic of the tightening, the big competitors or I should say lenders who are more on the prime or near prime space. In the last recession, you took a lot of share and grew a ton of profitable business from people who aren't typically shopping at your stores; but because of tightening, that came down. I guess, just curious what you're seeing today in terms of who is coming into the stores physically and virtually through your e-com business. Are they the same type of customers that you'd interact with? Or are you actually seeing different customers, maybe higher tier customers? And then, for those customers that you might not normally be seeing but are seeing now, are there any specific types of products or buying or need differentiators there? Thank you.

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

A

Yeah, good question. What we know is that the customer we're seeing has a higher – when we put him through our decision engine, it comes out with a higher quality score than before this, which to us means that the lenders above us, subprime or prime lenders, are pushing more down because we're getting a better credit coming into our transaction. As far as the – and then, on the website, the fact that our new customer traffic has doubled what it was a year ago, it tells us that there's a lot of new customers coming, they're higher quality customer. And I mean, higher quality from a credit decisioning, not necessarily the person; I don't want to cast any [indiscernible] (00:56:24) there. But just from a credit quality standpoint, they are higher-quality customer, and the fact that it's doubled.

And from a product mix standpoint, and doubled as far as the e-com traffic with new customers. As far as the product mix, no, we're not seeing any shift there. Again, the early on, it was more towards things you'd consider a little more essential. But now, it's spread out. I mean, furniture, televisions and things you'd consider more essential these days like laptops and appliances, refrigerators and so forth. But that early on, it was more just the essential products; and now, it's a pretty even spread that we normally see.

Vincent Caintic
Analyst, Stephens, Inc.

Q

Okay. Perfect. Well, thank you for the detail. Thanks. Thank you.

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

A

Thanks, Vincent.

Operator: All right. And there are no other questions at this time. I'll turn the call back over to Mitch Fadel, CEO, for final closing remarks.

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

Well, thank you, operator.

As I just mentioned, I'd like to take one more opportunity to thank our store coworkers, who have done such a great job, safely taking care of themselves and our customers, all while dealing with an increase in demand for our products and services. And I'd say, our frontline store coworkers reserve a tremendous amount of credit. And I want to point that out again, and I want all of you to know how much we appreciate you out there in the stores. I was out visiting some stores the other day, and I just can't be more thankful of the effort we're getting out of our store coworkers. They're doing a great job, and I want to take one more opportunity to say thank you.

And thank you to everyone else who joined us on this call and for your continued support. So, go on and have a really good day, everyone, and stay safe.

Operator: Thank you. Thank you, everyone, again for joining today's call. This concludes the conference. You may now disconnect.