Rent-A-Center, Inc.
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Participants:

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

Jason: Thank you all for joining us today, and thank you for those who are joining us virtually. I'm Jason Haas and I cover the lease-to-own industry here at Bank of America. And I'm really excited to be joined today by Maureen Short, who's the CFO of Rent-A-Center. So thank you again for being here.

Maureen: Thank you.

Jason: So diving right into questions. First one is just on, how do you think we should think about growth and operating leverage coming out of what seems like it will be an investment year in 2022?

Maureen: So 2022 does look a little different than the prior couple of years. We did at Rent-A-Center benefit from some of the government relief programs related to the pandemic, and so our customers have benefited from having more liquidity. And so, we're coming off of that now and comping over it.

So from an operating leverage standpoint, there's some really key drivers, include the delinquency rate and the loss rates, and those will be higher this year coming off of, again, our customers having more liquidity last year and moving on to a more normalized environment and with some underwriting tightening that we've made that will impact the overall operating margins of the business.

Jason: Thanks. Can you talk about the health of your core customer and just how it's changed? I think it has shifted a little bit faster than others were expecting. So I'm just kind of curious how you're thinking about the health of the customer and just overall what you're seeing in terms of this payment activities and just this environment overall.

Maureen: We're getting a lot of questions about the health of the low income, cash and credit constrained consumer, and it is a big shift year-over-year. In 2022, we're expecting the higher delinquencies, higher loss rates, mainly driven by much of the government relief programs where they were flushed with more cash and liquidity than they've had. Coming off of that is a dramatic difference. Most of our customers have spent through the additional funds that they received and are moving more to a normalized environment.

It was a more dramatic shift. We expected the back half of 2021 to be a more challenging credit environment as those programs came to completion. But it happened much more quicker and deeper than we originally expected. And that caused some of the underwriting where we took advantage of the better credit environment and loosened a little bit with our underwriting of the Acima business and that caught us a little bit off guard because it happened faster than we expected.

So now we've been tightening, given some of the high inflation rates, so it's tougher for our low income consumer, which does not have a lot of discretionary income with these inflation rates. And so, we've tightened the decision engine and are at the point where we're starting to see some improvement in early payment activity with our customer base. And so with that tightening, we expect to improve our margins and underwrite the business more to this current credit market or where our customer is currently at.

Jason: Thanks. Just sticking with that, you mentioned it briefly, but I was curious about just the impact of inflation on the business. Can you talk about sort of how the customer sees prices in the industry since I know it's unique relative to maybe others of retail?

Maureen: It is, yes. A little bit of inflation can actually be positive for our business. If our customer base, if they can't afford to buy the products outright at full retail cost all at once, they can spread those payments out and it can bring more customers into our lease-to-own transaction than previous. But at these inflation rates it does cause some negatives for the business as well if customers are not able to keep up with their payment because of high gas prices or using a lot more money to buy their grocery bill. So it can be challenging in this environment for our customers.

Jason: Thanks. And how about higher interest rates? How does that impact you guys in the industry overall?

Maureen: Typically if it's a tougher economic environment, higher interest rates lead to tightening of credit, which can be beneficial for us, and it's why the Rent-A-Center business has been pretty resilient through multiple economic cycles. When the higher credit spectrum, the financing options tighten up, then that leads to more higher income consumers coming into our transaction. We may see some fallout at the bottom for lower income or lower credit spectrum consumers, but usually they're offset with new customers coming in that have better credit metrics. And so overall we tend to be pretty recession resilient.

Now when there's this abrupt change in the macro environment, it causes some additional challenges, but that dynamic of the business where you see new customers coming in tends to offset a lot of the negatives.

Jason: That's great. Shifting gears a little bit, can you talk about capital allocation priorities for the year and just how you're thinking about capital return, such as future repurchases?

Maureen: Yes. So we're a pretty heavy free cash flow business. We generate enough excess cash to pay a pretty sizable dividend, which is a high priority for us. We also have a leverage ratio of about 2.3 times, which we feel comfortable with, but we also have a longer term target leverage ratio of 1.5 times. And we're a little more focused on bringing down the debt this year, just given the uncertain environment. But we also consider share repurchases opportunistically.

Jason: How are you thinking about the competitive landscape right now? And just how do you feel about your current position versus competitors?

Maureen: The competitive landscape has been fairly consistent over the last few years. It is a highly competitive environment within the virtual lease-to-own business and we feel very confident in our competitive position. We're one of the largest. We are the largest overall lease-to-own company in the industry and the competitive environments or dynamics haven't changed that much.

We feel like we have some differentiation factors where we can underwrite more deeply because we offer a staffed model, not just the virtual model. We also have some proprietary technology innovations that we've rolled out that others don't have in the Acima ecosystem that allows our customers to go to merchant locations and execute a lease transaction, even if we don't have a partnership with that merchant provider, which again no other competitors have today.

Jason: Got it. I think one thing that's unique about your model is that you do have both the virtual side of the business and the traditional stores. Can you just talk about sort of what synergies or what benefits you've seen from having both of those under one company?

Maureen: Yes, we do think it's a benefit to have both the traditional brick and mortar Rent-A-Center side of the business in addition to the virtual lease-to-own business. Because of those synergies, we've combined the operations so we can have one POS system versus two. So there's some corporate synergies within technology and other functions that we've already rolled out.

But probably more importantly, we can also leverage the Rent-A-Center business to take on return product if the Acima customers stop paying and we need to repossess the product. Then the Rent-A-Center stores have the last mile logistics and the reverse logistics where we can go out to customers' homes, pick up the product, bring it back to Rent-A-Center stores, and release the product.

There's also centralized decisioning [sic] within both companies and that's opportunities to condense that down into one decision underwriting tool and to make it even better. So there's definitely synergies between the two businesses and benefits for having both.

Jason: Just to follow up on that, have you started to take back returned merchandise from Acima and start putting it through the Rent-A-Center stores or is that something that's maybe being worked on, but not fully rolled out yet.

Maureen: It's the latter, yes. We've built the technology to enable that process to happen, but we have not fully rolled that out or emphasized that as a process that is fully rolled out at this point. But it's an opportunity this year that we're exploring and think that could definitely benefit the business by reducing losses.

Jason: That also will benefit you in terms of you could underwrite a little bit looser potentially.

Maureen: Right.

Jason: Got it.

Maureen: And that's the main thing that merchants care about as far as when they're choosing which competitor, which virtually lease-to-own provider to go with is how many – which lease-to-own operator can generate the most sales for me and the most incremental business. And if you can mitigate your losses through the return logistics, then you can underwrite more business and generate more partnerships.

Jason: Got it. Maybe sticking there since we're talking about it. I'm curious about, for the Acima business, when you go to a retail partner, either a current one or one that you're pursuing, what do they care most about? Is it the approval rates? Are there other factors that they consider when they're picking a lease-to-own partner?

Maureen: Approval rates is definitely important. How much incremental business can you generate for me? Having a strong balance sheet is important, obviously for the larger national players. And yes, just general customer experience is also important, so the technology behind how a customer originates a lease. We offer options through the customer's mobile phone. If we're on the e-commerce side of merchant partner, there's the e-commerce process flow. And it's a very seamless, easy process for our customers.

Jason: Does it surprise you that a lot of retailers don't offer lease-to-own, even though they have products and customers that are suitable for it? Obviously there are a lot that do, but I still feel like there's a lot of white space. So I'm curious just how you feel about that.

Maureen: Yes, there is still a lot of white space opportunities. There's a lot of large retail partners that have not seen the benefit of adding a lease-to-own option. Quite a few have started adding the Pay in 4, the buy now-pay later option, which we believe is a good opportunity to show the retailer that there are turndowns. There are customers that aren't able to take advantage of other financing options, and so having that lease-to-own provider, in addition to their other options, can generate more incremental business for them.

But yes, we add hundreds of new merchant partners every month, so there's still plenty of demand and white space opportunities. And we think that that will be around for the foreseeable future, just given the huge white space opportunity.

Jason: That's great. Can you talk about the efforts that you've done to better serve, I guess, both your retail partners and the end customer in terms of e-commerce, both on the Acima side and also the Rent Center business side?

Maureen: Yes. So at Rent-A-Center our e-commerce platform is rentacenter.com. We've enhanced the experience. You can originate a lease fully online. You don't have to come into the stores to select the product. You can fully transact online. We've added additional functionality, including the shopping cart; just enhancing the customer experience, making it easier.

We've shifted more of our marketing dollars to more digital marketing options to encourage more customers to go through the e-commerce channel. And we've seen strong new customer growth coming through the web. We've seen 50 to 60% of customers that sign up for an agreement through e-commerce are customers we've never seen before at Rent-A-Center. So a great growth platform for the Rent-A-Center side of the business.

With Acima, there's multiple strategies there. One, we're adding e-commerce to our existing merchant partners. And we are also partnering with e-commerce only retailers like Wayfair and offering both services. There's also an Acima marketplace where it's our website, but we have merchant links within there to where you can go through to merchants that we don't have integrated relationships with, but you can transact with an Acima lease through large national retail partners. So there's a number of technology initiatives that will help drive e-commerce growth for the combined business.

Jason: Is it more challenging to run an online business or an e-commerce business because you have less information about the customer? Or do you feel like now that – I know your Rent-A-Center stores have centralized decisioning [sic]. Do you feel like since it's already sort of algorithmic-driven, it makes it a little similar and loss rates aren't much higher on e-commerce?

Maureen: They are. They do tend to be a little bit higher when you're fully transacting online and you don't have that face-to-face identity verification process, so loss rates are a little bit higher. But what we've seen is the e-commerce customer tends to stay on rent a little bit longer, so generate more revenue for the business, and they tend to offset each other.

Another benefit to us is our stores act as many distribution centers. So our e-commerce business leverages the store base to deliver the product and service the product, so there isn't incremental cost in real estate or labor for our e-commerce business. So it's highly incremental and helps our operating margins.

Jason: Got it. That makes sense. So shifting gears a little bit, I'm curious to talk about some of the current issues going on with the Acima business. Can you just remind us? I know it was actually talked about on your earnings call. Just sort of what the issues are there, what you think the root causes are, and what sort of mitigation efforts you're taking to sort of course-correct that business.

Maureen: Yes. So with the change in the customer environment for the cash and credit constrained consumer, it caused us to need to adjust our underwriting. So in the back half of 2021, with the wind down of the government programs, we saw higher delinquency and loss rates for our customers, and so we started to tighten our underwriting; meaning we lowered our approval rates and we lowered the amount of lease approval for higher risk customers. And that meant that it slows our GMV growth, but it will improve our yields or EBITDA margins, given this credit environment.

So we did have to shift the underwriting levels or adjustment factors in order to account for a different macro environment. Now with the higher inflation rates and with the customer having less cash and less savings than they had previously, we're making adjustments. And in the October timeframe we started to tighten, but we saw continued deteriorate within our credit metrics, so we tightened again within the fourth quarter, and then again in January.

So the mitigation efforts are really lowering approval rates so that we can generate higher returns on leases that are underwritten in this new environment. So we're factoring in the new macro environment and making sure that that's part of the decision process.

Now it will take some time for the leases that were underwritten before we tightened to fully go through the lifecycle of the process, which is why we said in our guidance that front half of the year would have higher delinquencies, higher loss rates, lower margins than what we would see in a typical year as we work through those lower performing leases. But the back half of the year, we'll see the new underwritten leases as a bigger mix of the overall portfolio. And so, we'll see favorable trends with delinquencies and loss rates.

And based on the changes we made in December, we started to see those early indications. We look at things like first payment missed rates or how customers didn't make that first payment when the due date came up. And that's a great predictor, an early indicator of future lease performance. So we've seen some positive signs that the underwriting changes that we're making and we'll continue to optimize over the next few months where it's not something that happens overnight. But we're seeing some positive trends and changes based on what we've done so far.

Jason: That's great. So a follow up question on that. You've guided to GMV growth down mid singles digits for the year. I'm curious, how much of that has been driven by your own underwriting decisions versus if you're starting to see any slowdown in customer demand for products?

Maureen: It's primarily the underwriting. We continue to see application volume growth. We continue to add new merchant partners every month and we expect that to continue. So it's really tightening our decision-making process that's adjusting, not the overall demand is coming down. We may see some of that with inflation where it is, where gas prices continue to increase.

But what we're seeing so far and what's in our guidance is that we continue to see that strong demand, both on the Acima side, as well as the Rent-A-Center side. It's more of us becoming a little bit more restrictive in who we're approving, just given this credit environment.

Jason: When you talk about being more restrictive with your decisioning, is that a function of just sort of tightening this spigot and you're just approving less people? Or are there any other changes that you're making in terms of the algorithm or investments in like labor or technology to sort of improve that decision engine?

Maureen: It's a combination, but it is mainly determining which customers to approve and taking that higher risk bucket and approving less of those customers and them approving less of an amount, an approval amount. So if you were approved in the past for $1,500, maybe now we only approve you for $1,000.

There's some additional changes that we're making. We're investing in new technology, which is a continuous thing to help improve the decision-making process. There's certain fraud tools; that now that e-commerce is becoming a bigger piece of the business that we're investing in to help reduce the amount of fraud coming through e-commerce. But it is mainly just approving less customers.

Jason: That's great. You talked just a moment ago about you're starting to see – as you've tightened, you're starting to see fewer, I guess, delinquencies and loss rates. So I'm just curious if you could talk about like how real time those metrics are? Just how confident are you in your skip/stolen guidance for the year, just given how quickly you can sort of manage that portfolio.

Maureen: It does take a little bit of time. Our customers can have weekly terms, biweekly terms or monthly terms. And so, once we make a change, we'll see the weekly and biweekly metrics come in very quickly. But then the monthly customers, you have to wait a month to determine what percentage of those customers miss that first payment.

And then there's also a same-as-cash period in the first 90 days where customers can take advantage of lower pricing if they're able to buy out of that agreement within the first 90 days. Once we get past that period, the visibility becomes a lot more predictive of overall lease performance. So we can see some early signs, but then others, it takes a little bit of time to increase the accuracy or the predictability of how the leases will ultimately perform.

We did assume higher loss rates in the front half of the year. Fairly similar to what we saw last quarter, in the fourth quarter for the Acima business. The Rent-A-Center business is a little more stable. The high 3% of revenue is what we're expecting, which is very similar to historical rates for the Rent-A-Center business.

Jason: And how are you thinking about the cadence of GMV for Acima throughout the year?

Maureen: So the tightening is happening early in the year. We expect that continue. As we see more positive trends, we may adjust that throughout the year. But we saw a little bit of a lower GMV growth rate in the fourth quarter, and then we'll see continued tightening from the changes we've made so far this year and expect that to be down low – I'm sorry – down mid-single digits for the full year.

Jason: Are you concerned at all that you could lose business if your merchant partners see that you're tightening? Because I know you said before they care a lot about approval rate, so I'm curious if you think that's a risk at all you could see in some share during this period.

Maureen: We're being very strategic as we look at different merchant partners and as we look at different channels. We're being surgical when it comes to – if there's certain channels or merchants where we believe that there are higher risk customers, we can tighten in those areas. If there's more national partners or strategic relationships, we have the ability to adjust differently for those merchants than others. And so, it's really under our control as far as how much we tighten and what that mix looks like overall in the portfolio.

Jason: And my next question was on whether this would preclude you at all from adding a large national retail partner, if one was available.

Maureen: We don't think so. We're definitely interested in continuing to pursue and add national retail partners. There were opportunities last year. We were able to sign up a few well-name retailers and believe that that continues to be an opportunity for us. Given this challenging environment, wouldn't be surprised if our competitors are around the same amount, they're doing the same amount of underwriting as we are.

We may have been a little more aggressive than them during the pandemic, which I think proved to be positive for the business. We were able to increase market share, generate a significant amount of 20 plus GMV growth last year, which was beneficial for the business. So we may be doing a little more tightening versus where we once were. But overall, they're probably pretty similar in which customers they approve in this environment.

Jason: If we think about loss rates across different types of merchant partners or different types of categories, I know you just said that for a retailer that may be serving an even lower income customer, maybe the loss rates were higher. But I'm curious if there's been any noteworthy the trends across categories or the types of merchant partners that you serve in terms of the loss rates.

Maureen: It's been pretty consistent across the board. There's certain partners where they have higher loss rates than others, just given the customer that they serve. But we can be very surgical, as I mentioned, on how we underwrite to try to account for that. For example, jewelry historically has had higher loss rates than appliances. And so, we're a little bit tighter with the underwriting for jewelry than other products. And that's something that we can account for upfront and mitigate losses on the backend.

Jason: Got it. I also wanted to make sure I ask about the Acima ecosystem and also the LeasePay Card pilot. So can you just walk through those for maybe for those who aren't as familiar with it, and just what sort of progress you've made there?

Maureen: Sure. So we spent a good deal of time last year innovating new technologies around how to originate leases within the Acima ecosystem. And there are several different options available now for customers, including the ability to originally lease through their smartphone on a mobile app. We've had around 500,000 downloads of the Acima app, so we're seeing some positive demand there. This is all still in test mode, so we're still trying to better understand the economics of how these originations look, but there has been good demand with the mobile app.

We also have a marketplace, which I mentioned earlier. It's basically a portal on a website where we market directly to consumers instead of go them going through a merchant partner. But it allows them to come out to the Acima marketplace website, click on whatever retailer they're interested in, and there's a variety out there; large names that you would know, different products that are offered.

And they can basically go through to their website and transact through Acima where we buy the product from the online retailer and lease the product to the consumer. And then there's also a browser extension if you want to go through using your laptop or a desktop, and again, transact with the Acima.

We also rolled out, in test mode, a LeasePay Card, which is the first of its kind. It's a way to approve customers for a lease. Actually put that lease amount on a virtual card or even a plastic card to where they could take it to any retailer and swipe it at the point of sale. After they scan the product so that we make sure that it's a household durable good, so a leaseable [sic] type of product, and then they swipe their card, which pays the retailer. And then we lease the product to the customer.

So these are all out there in test mode we're monitoring and we've seen some interest in the product. And we're excited about the ability to be able to increase the TAM, the total adjustable market. Because currently we are only – you can only do a lease-to-own transaction about, call it 100,000 locations, we're in about 38,000 locations at Acima. And this could expand it to about 2 million locations because we've got an agreement with MasterCard so that we can use the LeasePay Card in any of their locations.

Jason: Great. So we're starting to near the end of the session, so I think it's a good time to maybe just poll the audience or cue the audience. If anyone does have a question, just raise your hand and make sure you wait for the mic to arrive and then you can ask it.

Audience Q&A

Q: You mentioned household products and I'm just wondering – or appliances. Given the bottlenecks in the port of LA, is that impacting your bottom-line or ability to access products that might be higher margin?

Maureen: The supply chain issues have caused some challenge for the Acima business in particular, because some of our merchant partners have struggled to stock their stores with the breadth of product that we've had historically. And so yes, we have seen more customers cancel because it's taken three or six months to get the product. I'm sure we've all experienced the same type of thing. And that is, we believe, negatively impacting the business.

We do also see some inflation within the product that we buy on the Rent-A-Center side. We're able to pass most of that pricing increase onto the consumer since they do spread the payment out over 12 to 18 months. It's just a little bit higher cost to the customer and we can spread those payments out.

Q: I think you mentioned some regulatory risk on your call around AG's investigations. And I was just curious. What are the usual avenues are they going after and what is the risk to the – like how do we think about the risk to the business?

Maureen: So there are from time to time AG matters that pop up within the lease-to-own business. I think within this particular area, they're looking at the practices of virtual lease-to-own. I think it's a somewhat new concept so they're trying to better understand the virtual lease-to-own business. There have not been any specific allegations related to Acima, and we believe there's multiple companies involved.

As far as what could come out of it. I mean there's a range of possibilities. It could be nothing. It could be just an exploratory exercise. It could be fines. We've seen that at our competitors. And things can pop up from time to time there, but we're complying, we're providing the data that they've asked for, and we'll see what happens.

Jason: Thanks. We have time for maybe one or two more questions. The next one is just on – I want to switch over to the Rent-A-Center business and just ask, why do you think that business hasn't been as negatively impacted by the current macro environment relative to Acima?

Maureen: Good question. We believe a lot of that has to do with the local collections. We've got 2,400 stores that are able to go reach out to customers, whether on the phone or over text, and knock on people's doors. Take back the product if the customer is running into financial difficulty. We have a strong repeat business. About 80% of our business comes back to us at a different point in time. So if customers are going through a difficult adjustment period, we can take back the product and then they can pick up where they left off when they get back on their feet. So having that localized collections is definitely an advantage in this environment.

Jason: Thanks. And maybe last question to close this out. I'm curious. We talked a good amount about some of the challenges you're facing this year. We've heard that from a lot of companies. So I'm curious. What gives you confidence, as we look past 2022, that you're going to see a reacceleration in GMV growth? And that you'll see alongside that – I know you do have long-term targets for margins, etcetera, so what gives you confidence that after this year you could see a reacceleration in the business.

Maureen: That's, I think, a very important question. We do feel like this is an adjustment period. It's been a dramatic shift for our customer base, but we don't have any reason to believe that we can't get back to where we were with strong GMV growth, high demand from our customer base, and strong margins. We're continuing to see application volume growth. Again, adding hundreds of new merchant partners. There's a giant white space opportunity out there. Many retailers that we just talked about that don't have this option that can generate incremental sales for them, especially when they're trying to comp over the stimulus periods.

And really nothing fundamentally has changed in the business that change our beliefs about the mid-teens EBITDA margins, the strong GMV growth of the business, so that really gives us a lot of confidence. Once we get through the underwriting changes, the higher delinquencies and credit that we're seeing, we'll underwrite to the appropriate level, given the macro environment and get back to strong earnings growth.

We do think that there's a great story to be told with Rent-A-Center. We've got strong earnings growth, we've got a great dividend and just a lot of earnings power with the business, potentially multiple expansion, especially given where we're at right now. So it is a temporary adjustment period, but we still believe strongly in the growth prospects of the business.

Jason: That's great. All right. I think we'll leave it there. Thank you all for joining us and thank you as well, Maureen, for joining us, too.

Maureen: Thank you very much.

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