

Upbound Group, Inc (Q3 2024 Earnings)

October 31, 2024

Corporate Speakers:

- Jeff Chesnut; Upbound Group, Inc.; Head of Investor Relations
- Mitchell Fadel; Upbound Group, Inc.; Chief Executive Officer
- Fahmi Karam; Upbound Group, Inc.; Chief Financial Officer

Participants:

- Vincent Caintic; BTIG; Analyst
- Robert Griffin; Raymond James; Analyst
- Hoang Nguyen; TD Cowen; Analyst
- Bradley Thomas; KeyBanc Capital Markets; Analyst
- John Hecht; Jefferies; Analyst
- John Rowan; Janney Montgomery Scott; Analyst
- Anthony Chukumba; Loop Capital Markets; Analyst

PRESENTATION

Operator^ Good day. And thank you for standing by. Welcome to the Q3 2024 Upbound Group Earnings Call. (Operator Instructions) Please be advised that today's conference is being recorded. I would now like to hand the conference over to your first speaker today, Jeff Chesnut, Head of IR. Please go ahead.

Jeff Chesnut^ Good morning. And thank you all for joining us to discuss the company's performance for the third quarter of 2024.

We issued our earnings release this morning before the market opened, and the release and all related materials including a link to the live webcast are available on our website at investor.upbound.com.

On the call today from Upbound Group, we have Mitch Fadel, our CEO; and Fahmi Karam, our CFO.

As a reminder, some of the statements provided on this call are forward-looking and are subject to factors that could cause actual results to differ materially and adversely from our expectations. These factors are described in our earnings release as well as in the company's SEC filings.

Upbound Group undertakes no obligation to publicly update or revise any forward-looking statements, except as required by law. This call will also include references to non-GAAP financial measures.

Please refer to today's earnings release, which can be found on our website for a description of the non-GAAP financial measures and the reconciliations to the most comparable GAAP financial measures.

Finally, Upbound Group is not responsible for and does not edit or guarantee the accuracy of our earnings teleconference transcripts provided by third parties. Please refer to our website for the only authorized webcast. With that, I'll turn the call over to Mitch.

Mitchell Fadel^ Thank you, Jeff. And good morning, everyone. I'll begin with a review of the key highlights from the third quarter.

Fahmi will share a more detailed review of our financial results and our financial outlook, and afterwards, we'll take some questions. To begin, I'm very pleased to share that our third quarter revenue was nearly \$1.1 billion. Adjusted EBITDA was approximately \$117 million and non-GAAP earnings per share was \$0.95, which was right at the midpoint of the guidance we provided on our last call and a couple of cents above the average of our Street consensus estimates.

Acima led the way with revenue up 19% year-over-year with Rent-A-Center delivering a 110 basis point improvement in revenue against the prior year despite the impact of about 50 store closures we mentioned last quarter.

In addition to a recent sale of 55 stores in the New York Metro area to an existing franchisee. And I'll discuss the successful execution of that franchisee sale in more detail shortly.

Acima delivered another strong quarter of GMV growth with a 13% increase year-over-year, which was in line with our stated guidance of low double-digit growth as we start to comp against the accelerated performance from the latter part of 2023. Last quarter, we also shared our outlook for the third quarter lease charge-off rates and are also consistent with those projections. Acima's lease charge-off rate improved sequentially and year-over-year to 9.2%.

On the Rent-A-Center side, we expected -- as expected, we did experience a seasonal sequential increase to 4.9%, which was slightly above our earlier expectations as the environment for our consumers remains challenging.

Now despite the tick up in losses at Rent-A-Center and they remain at an acceptable level to optimize risk-adjusted returns, especially when you think about the environment we're in, while also delivering EBITDA margins in line with our targets. Rent-A-Center's adjusted EBITDA margin of 16.3% increased 130 basis points year-over-year, while Acima's EBITDA margin came in at 13.3%. And that slight decline at Acima is in line with our target of low to mid-teens adjusted EBITDA margins and reflects some trade-down dynamics that I'll speak to in the segment results.

Importantly, based on our current visibility, our forecast for the holiday season and our ability to exercise the operating levels at each of our larger segments, we expect to achieve the full year guidance we provided last quarter.

Now before we review our segment results, let's discuss one of the key themes we've seen across this past quarter.

At Acima, we've continued to see credit tightening above us, driving trade down with better quality -- better credit quality consumers coming to us. The lenders above us and retailer checkout flows have implemented mitigating actions in response to higher delinquencies and pending regulatory changes for credit card late fees, which allows us to selectively tighten our underwriting in certain higher risk areas as we work to optimize our risk-adjusted returns.

But even as we adjust at the bottom, our business still enjoys strong prospects for growth across our portfolio, and that's the benefit of trade down activity.

Our Acima business experienced over a 25% increase in applications compared to a year ago quarter, and our overall applicant pool had higher third-party scores. And with Acima continuing to grow its overall number of retail relationships, we're able to reach more new customers even as we're more selective in our decisioning.

So with that context, I'm very pleased that our team delivered results that met expectations on revenue and adjusted EBITDA and non-GAAP EPS. I'm confident their performance will help us achieve our full guidance across the balance of the year while managing through these uncertain times.

So let's move on to Slide 4 in our presentation, and we'll talk through more specifics about our segment results. At Acima, we continue to be a growth leader in our industry as we achieved our fourth consecutive quarter of GMV growth with a 13% lift in Q3 compared to a year ago period.

As we mentioned last quarter, we expected the rate of year-over-year growth to moderate in the second half of the year as we start comping against the acceleration of our growth and the elevated performance that really began in September of last year.

Now powering that growth is Acima's proven algorithm, which is supported really by three pillars: adding new merchants to the Acima network, expanding our productivity with existing retailers, and inviting consumers to start their shopping journey through Acima's direct-to-consumer marketplace.

Our field organization grew our active location count again this quarter, increasing 10% year-over-year, 10% growth in locations, while working with our retailers to boost our lease productivity metrics.

We also had several joint marketing campaigns with our retail partners promoting their sale events in the quarter, things like Way Days at Wayfair and Amazon Prime Days.

We're continuously promoting our retailers, whether it's in store, on the e-com sites or through our own marketplace. And our direct-to-consumer marketplace continues to grow, contributing toward the GMV growth in the period, and that effort will remain a focus for us going forward.

The visitors we welcome to our marketplace are generally returning customers, which means lower underwriting costs, stronger loss performance and higher lifetime value than the broader set of our customer universe. These growth pillars translated into a 19% revenue lift for Acima year-over-year, and our proactive risk management strategies helped yield that lease charge-off rate of 9.2%, which was down 40 bps sequentially and down 20 bps year-over-year.

Segment level gross profit and EBITDA margins were down against both year-over-year and sequential comps, driven in part by the residual impact of the ANow transition and an increase in 90-day purchase option activity, which was heightened due to trade-down dynamics.

We're excited about the opportunity that trade down represents, but the performance profile of these generally higher scoring customers is a bit different than what we've experienced recently from our core consumers. These customers tend to elect more often the earliest purchase option on the lease transaction, which is the lowest margin outcome for Acima other than a charge-off account. The upshot and the bright spot of all this is that we're meeting new customers and helping them at the point of checkout when their traditional options are less available.

So since customers that exercise the purchase option typically execute repeat transactions, we'll encourage them to visit our third-party retailers through our marketplace, which we believe will enhance our lifetime value with that consumer and drive more sales to our partners. All that being said, even with the EBITDA that takes a while to catch up with all the strong GMV growth in our business, the remaining headwinds as we work through the legacy ANow back book and an increase in lower-margin early purchase activity, Acima still came in within our long-term low to mid-teens EBITDA margin range at 13.3%, a really strong quarter for Acima across the board.

Let's shift over to Rent-A-Center, where the competitive landscape has changed notably since our last update. RAC saw some of its long-time competitors go private, some reorganizations and even liquidations.

Our recent results highlight the strength of the Rent-A-Center brand and our coworkers who bring that brand to life through connections with our customers and their communities. Between Rent-A-Center's leadership and our thousands of store associates, we're ready to support those customers that may be seeking a new store in their neighborhood or even online options to help access the everyday products they need to

improve their quality of life. Along those lines, we're actively marketing to those potential customers to guide them in the moment they may be looking for alternatives.

We're using things like geographic overlays and geofencing, behavioral data and even contextual AI to sharpen our targeting efforts and increase the efficiency and effectiveness of that campaign. And that's on top of our strong foundational marketing efforts that we do every day. And those marketing levers, along with our continued focus on operational improvements, helped Rent-A-Center finish the third quarter with same-store sales growth of 2.6% against last year's Q3.

Others are struggling, even shutting down yet the strength of Rent-A-Center's brand and value proposition and people has now driven three consecutive quarters of same-store sales growth and adjusted EBITDA margins above 16%. Really pleased with the performance of the Rent-A-Center business as well.

From a channel perspective, Rent-A-Center's e-commerce activity represented over 26% of revenue in the third quarter, an increase from approximately 25% in the third quarter of 2023 due to our team's efforts to optimize our digital customer experience.

We've also launched a partnership with Google to leverage generative AI to enhance the personalized experience on our reentacenter.com website that should drive even better performance in the future. Even with the adjustments to Rent-A-Center store count, the segment achieved revenue growth of 1.1% year-over-year with a gross profit margin in line with prior quarters.

As expected, the lease charge-off rate at Rent-A-Center was elevated in Q3, landing at 4.9% compared to 4.3% in the prior year, partially due to seasonality, but also due to stress on Rent-A-Center's traditional customer.

As I've mentioned, we're monitoring performance closely and making adjustments in real time to protect that margin profile.

So wrapping up this slide, I'd emphasize this quarter was a busy one with a number of strategic initiatives in flight that we believe will position us to have a successful finish to the year and a strong start to 2025. Acima added numerous new clients to help sustain our GMV growth and start building the next generation of the staff model stronger performing go-forward portfolio.

The Rent-A-Center team executed an EBITDA-enhancing transaction with a key franchise partner while reacting in the moment to capitalize on a market opportunity related to competitive developments. Collectively, these achievements have us on track to meet the 2024 guidance we provided across the course of the year.

On Slide 5, let's review the status of the strategic priorities we outlined for the year.

For Acima, we highlighted customer retention as a focus area in 2024, and we've been reimagining the way our Acima customers apply, shop and check out with us.

We know there are additional opportunities to streamline and modernize our processes, and we're currently working to expedite the leasing process for returning customers while removing friction points in the application flow for new customers. These changes will be ongoing and targeted rather than discrete in wholesale, and we believe they'll benefit our business, our merchants and most importantly, our customers.

From a market share perspective, Acima continues to add retail nameplates and build out the capabilities of the Acima marketplace.

Now we don't often mention all of our wins, but given the attention recently around one regional account, we felt it was important to level set on the growth we've achieved and the prospect of future growth opportunities.

Acima is up over 10% in locations year-over-year, and we consistently outgrow all of our competitors when it comes to new doors. And of course, our GMV numbers speak for themselves.

Our current and growing lineup of diverse partners will help amplify our growth as the furniture industry, our largest segment, inflects back to positive trends after years of demand being pulled forward. Until then, we'll continue working to add new retailers across all of our key verticals while continuing to provide superior service to our existing merchants so that we maintain a well-diversified mix of larger, medium and smaller-sized clients.

In the third quarter, our largest retailer represented approximately 6% of total GMV and the top five were collectively approximately 22%.

Despite the transition of that one account, we're raising our view of the fourth quarter GMV to low double digits. Our confidence in continuing to grow GMV speaks to the diversity we've built in our business, diversity in merchants and in product categories.

We're particularly excited about elevating the digital capabilities of the Acima marketplace, which continued its strong growth trajectory with over a 30% increase in the third quarter of 2024 compared to the prior year period.

Our teams remain focused on enhancing the marketplace infrastructure including the implementation of our new and proprietary AI-powered leasability search engine, which has helped simplify the process for onboarding new unintegrated merchants. This particular upgrade enabled the recent additions of national brands that have just been added to our marketplace, such as Amazon, Walmart, Target and eBay that have been recently added to the marketplace and will enhance the experience of our existing merchants also with that technology.

This AI-powered leasability engine also allows us to expand previously unavailable durable good categories for lease to own.

If you think about it, without this remarkable proprietary tool, which our team built with Google, you simply cannot sift through all the leasable products on a website like Amazon. And now we can. And we just started doing this earlier in October, and its capabilities to help us grow this channel even further are incredibly exciting.

We're also building toward rolling out our updated virtual lease card program, which will facilitate a simple and safe shopping experience for users with advanced fraud protocols designed to minimize losses and maximize profitable leases.

This updated virtual lease card will allow returning customers to shop in-store at any retailer they're choosing to find eligible goods to lease from Acima.

Our goal of these investments is to reinforce Acima's reputation as the premier LTO shopping destination for our customers and add meaningful growth engines for the business for many years to come.

At Rent-A-Center, we continue to make progress delivering more value and better experiences for our customers. Along those lines, and as I mentioned earlier, in Q3, we completed an opportunistic sale of 55 stores in the New York City metro area to a current Rent-A-Center franchisee that has a very successful track record with us. This deal is a win for our customers because this new owner can optimize the business processes to serve those stores.

New York City, of course, is a pretty unique operating environment and one we believe will benefit from a locally run business that can more readily implement tailored processes to address some of the local conditions that are so much different there than the rest of the country.

From a financial standpoint, we'll be replacing sales revenue with royalty revenue. So Rent-A-Center's top line will be modestly impacted by the loss of those stores, but we expect the operating results will be EBITDA enhancing to us.

In other words, because our normal operating model wasn't the best fit for New York City, and it wasn't that profitable of a market for us, this franchising effort is actually EBITDA accretive based on royalties from the franchise stores.

I can also tell you, we've been looking for a franchisee to operate that market for many years, all the way back to when we did the same thing with the California market in 2020.

So I'm really thrilled we're able to partner with this existing franchisee to make this happen, and I'm very excited about the future of Rent-A-Center in that market for our customers, that franchisee and our company. Earlier this year, you'll recall where we

consolidated similar number of stores when we had upcoming lease renewals in nearby stores that could absorb the customer base.

We expect to retain a healthy proportion of that customer activity and our early indications point to our efforts working well. Over the past two quarters, we've seen changes to optimize our store count. That's a natural and responsible reaction to managing nearly 2,000 stores across the country.

Even as we enhance our digital footprint, our stores remain the center of gravity in our relationships with our customers while adding on-the-ground synergies to Acima's virtual platform.

We'll continue to optimize our 1,700-plus corporate-owned store footprint as customers' needs and neighborhood dynamics change. But in general, our philosophy going forward will be to remain net neutral with our current store count.

Now that we've done the New York deal, and I mentioned we've been trying to find somebody for about four years for that market. In other words, we believe we're now done as far as any reduced store count, and we feel really good about our well-balanced store footprint going forward.

The Rent-A-Center team also leverages technology to drive better outcomes for the business and its customers. This past quarter, we deepened the rentacenter.com website integration with a key supplier to provide stronger visibility into the product models and availability, which helps improve the customer experience and lifts conversion rates.

We also strengthened Acima's underwriting fraud tools that Rent-A-Center utilizes to assess its online shoppers. It creates more opportunities to approve the right customers for a lease, which drives better outcomes for customers while minimizing potential losses.

Additionally, we continue to work towards positioning our business to be successful both today and in the economy of the future.

As I mentioned earlier, we've got a couple of different partnership things going on with Google, of course, a global leader in Gen AI, and we've developed a roadmap to deliver specific and measurable outcomes across customer experience, personalization and customer conversion.

In particular, Acima has deployed solutions to streamline the onboarding and leasing processes for key retailers, like I mentioned. Rent-A-Center.com is launching a more powerful search and recommendation engine and these initiatives, when up and running at full capacity, should provide significant customer benefits, drive transactions and enhance margins for our business and our third-party retailers.

At the Upbound level, we continue to make incremental progress with the credit offering through our partner issued cards. The Acima general purpose card can be used anywhere

Mastercard is accepted, and the Acima private credit card can be used across our current merchant roster.

From an account acquisition standpoint, we've seen promising growth in sign-ups from our digital properties as our consumers respond to offers and invitations featured on Acima's app as well as the desktop and mobile websites.

Our next stage of testing and learning will include holiday campaigns across direct mail and social media and Rent-A-Center's digital properties. This initiative is contributing modestly to our bottom line, but more importantly, it's contributing to our understanding of our customers' interests and desires and the broader dynamics of the consumer credit landscape.

While this partnership enables us to learn in a low-risk balance sheet-light environment today, it also helps prepare us for future opportunities to scale and grow. Now before I hand it off to Fahmi, I'd like to share a couple of final thoughts.

The first being that as a veteran of four decades in this industry and seeing the industry evolve and so forth, I know how durable our model is because it delivers inclusive shopping solutions to underserved consumers.

Whether at Rent-A-Center or Acima, our talented and experienced team is committed to helping our customers find practical solutions and our merchants find incremental sales. And even as things change, we're committed to being ready to deliver the next generation of solutions and value to each of our stakeholders. And lastly, I want to thank our team for their dedication and tireless efforts to support our customers and retailers.

As always, we're grateful for their ongoing dedication to our core mission of elevating financial opportunity for all. Their commitment to our customers is evident every day, and we sincerely appreciate it. So with that, I'll turn it over to Fahmi.

Fahmi Karam^ Thank you, Mitch. And good morning, everyone. I'll start today with a review of the third quarter results, then discuss our outlook for the rest of the year, after which we will take questions. Let's begin on Page 6 of the presentation.

We are very pleased to report another strong quarter with revenue growth over 9%, EBITDA growth of 10% and EPS growth of 20% compared to last year. Consolidated revenue for the third quarter was up 9.2% year-over-year with Acima up 19.1% and Rent-A-Center up 1.1%.

Rentals and fees revenues were up 8.8%, while merchandise sales revenues increased 18.2%, reflecting a larger portfolio balance at Acima coming into the quarter, more customers exercising the 90-day purchase option, and promotional initiatives at Rent-A-Center. Consolidated gross margin was 47.8% and decreased 300 basis points year-over-year with a 280 basis point decrease in the Acima segment and a 90 basis point decrease in the Rent-A-Center segment.

Consolidated non-GAAP operating expenses, excluding lease charge-offs and depreciation and amortization, were down low single digits due in part to nonlabor operational efficiencies at Rent-A-Center combined with overhead labor savings. The consolidated lease charge-off rate was 7.4%, a 40 basis point increase from the prior year period and broadly in line with our expectations.

On a sequential basis, the consolidated lease charge-off rate increased 20 basis points due to a 70 basis point sequential increase at Rent-A-Center.

Consolidated adjusted EBITDA of \$116.9 million increased 10.3% year-over-year due to higher Acima and Rent-A-Center segment adjusted EBITDA in addition to lower corporate cost. Adjusted EBITDA margin of 10.9% was up approximately 10 basis points compared to the prior year period, driven by approximately 130 basis points of expansion at Rent-A-Center in addition to a decrease of approximately 70 basis points in corporate costs as a percent of sales, which was partially offset by approximately 200 basis points of margin contraction at Acima.

I'll provide more detail on segment results in a moment.

Looking below the line, third-quarter net interest expense was approximately \$26 million, which was a slight decrease from the prior year period. The effective tax rate on a non-GAAP basis was 26.2% compared to 25.5% for the prior year period.

The diluted average share count was 56 million shares in the quarter. GAAP earnings per share was \$0.55 in the third quarter compared to earnings per share of \$0.08 in the prior year period, which was driven by the prior year tax impact associated with the vesting of restricted stock awards issued in connection with the Acima acquisition. After adjusting for special items that we believe do not reflect the underlying performance of our business, non-GAAP diluted EPS was \$0.95 in the third quarter of 2024 compared to \$0.79 in the prior year period, representing 20% growth year-over-year.

We distributed a quarterly dividend of \$0.37 per share, and we finished the third quarter with a net leverage ratio of approximately 2.6x after paying down our revolver in the quarter. Let's move to the segment results starting on Page 7.

For Acima, double-digit year-over-year GMV growth continued for the fourth consecutive quarter.

Following approximately 20% year-over-year growth in the prior three quarters, GMV grew 13% in the third quarter. The GMV lift was driven by year-over-year growth in key underlying drivers with active merchant locations up approximately 10% year-over-year, more productivity per merchant, and an increase in applications of over 25%.

Those tailwinds were partially offset by lower approval rates as we remain disciplined in our underwriting approach as inflation continues to impact our core consumer base. The net asset value of inventory under lease was up approximately 16% year-over-year.

Revenue increased 19.1% year-over-year including a 17.9% year-over-year increase in rentals and fees revenue and a 23.5% increase in merchandise sales revenue due to a larger portfolio at the beginning of the third quarter compared to last year and the impact of trade down.

Lease charge-offs for the Acima segment were 9.2%, 20 basis points lower year-over-year, and 40 basis points lower sequentially. The year-over-year decrease in Acima's lease charge-offs was driven by our continued underwriting discipline, the recent uptick in early purchase option elections, and the wind-down of the Anow back book.

Non-GAAP operating costs, excluding lease charge-offs, were up on a dollar basis, approximately \$4.3 million in the third quarter, which was 70 basis points lower as a percentage of revenue. Adjusted EBITDA of \$75.3 million was up 3.4% year-over-year, primarily due to the 19.1% increase in revenue that was partially offset by a 24.2% increase in cost of goods sold.

Adjusted EBITDA margin of 13.3% decreased approximately 140 basis points sequentially and decreased approximately 200 basis points year-over-year, primarily due to a 280 basis point contraction of gross margin compared to the third quarter of 2023.

The decrease in gross margin compared to the prior year was a result of a few factors including an increase in merchandise sales, which represented a larger percentage of revenue compared to the prior year period due to more consumers electing the 90-day purchase option and the conversion of AcceptanceNOW locations to the Acima platform.

For the Rent-A-Center segment, at quarter end, the same-store lease portfolio value was roughly flat year-over-year, while same-store sales increased 2.6% year-over-year, maintaining the momentum from the 2.6% year-over-year increase in the second quarter of 2024.

Total segment revenues grew year-over-year for the third consecutive quarter, increasing 1.1% compared to the third quarter of 2023. The increase in revenues was driven primarily by a 1% year-over-year increase in rentals and fee revenue, offset partially by a 40 basis point decrease in merchandise sales revenue compared to the prior-year quarter.

Lease charge-offs were 4.9% of revenue in the third quarter, 60 basis points higher year-over-year and 70 basis points higher sequentially, a reflection of expected seasonal trends as well as conditions that remain challenging for our consumers. 30-day past due rates averaged 3.4% for the third quarter, up 30 basis points from the prior year period. Although there was a slight uptick in losses and delinquencies, they both remain in an acceptable range for us to produce strong EBITDA margins.

During the quarter, we made tactical adjustments to our decisioning to help achieve our full-year target LCO rate in the 4.5% area and position us very well for 2025. Adjusted EBITDA margin for the third quarter increased 130 basis points year-over-year to 16.3%, primarily due to lower nonlabor operating expenses.

This is reflected by a 260 basis point year-over-year decrease in the ratio of non-GAAP operating expenses, excluding lease charge-offs to segment revenue.

For the Mexico segment, on a constant currency basis, revenue increased year-over-year, while adjusted EBITDA remained relatively flat. The franchise segment revenue decreased year-over-year, while segment-adjusted EBITDA increased compared to the prior year period. Non-GAAP corporate expenses were approximately 4.3% lower compared to the prior year. Let's shift to our financial outlook.

Our outlook assumes a stable macro backdrop consistent with current conditions, durable goods demand still recovering, and a holiday season that's not disrupted by external factors.

As Mitch noted earlier, for the full year, we expect to achieve the midpoint of the guidance that we raised on the second quarter call.

We are tightening the ranges around the midpoint for the full year. Revenue should be in the range of \$4.2 billion to \$4.3 billion, adjusted EBITDA in the \$470 million to \$480 million range, and non-GAAP EPS in the range of \$3.75 to \$3.90.

For the fourth quarter, we're pleased with the start through October and expect it will translate to low double-digit year-over-year GMV growth at Acima, which is higher than we expected coming into the quarter and a strong outcome given the 19% GMV growth at Acima posted in the fourth quarter of 2023.

That higher-than-expected GMV growth also means this year's free cash flow, which funds that growth is now expected to finish towards the lower end of our guidance.

We expect Acima's revenue to grow mid-teens year-over-year with gross margins similar to the third quarter of 2024 due to the mix shift towards the earliest purchase option. Lease charge-offs in the fourth quarter should be relatively flat sequentially and lower than the year ago quarter, in part due to the proactive measures we've taken to fine-tune our underwriting in certain risk segments. Expenses, excluding losses, should be lower, resulting in slightly higher Acima adjusted EBITDA margins compared to the third quarter. Rent-A-Center's fourth quarter outlook should see revenues down low single digits due to the franchise sale in the third quarter with lease charge-offs and adjusted EBITDA margins similar to the third quarter.

Corporate costs are expected to be up low single digits year-over-year.

Our lease charge-offs are slightly elevated compared to our long-term normalized target ranges for each segment, but remain at acceptable levels for us to continue to grow and achieve our target EBITDA margins.

We are consistently reviewing our portfolio performance and our decision engines are continuously adjusting approvals and approval amounts to remain competitive and disciplined in loss mitigation.

We prudently manage our decisioning based on real-time data to guide the business towards our targets despite the difficult operating environment we've seen in the past few years.

We're confident in our tools and our data-driven approach to make losses at an acceptable range until the macro improves.

In addition, if trade down continues, charge-offs should improve as that GMV becomes a larger mix of the portfolio.

While trade down has contributed to Acima's revenue growth, in the near term, it will continue to impact Acima's gross margins and adjusted EBITDA given the higher proportion of lower-margin early purchase outcomes, but it will eventually benefit losses and loss rates as that volume flows through the P&L.

In terms of the fourth quarter, we expect adjusted EBITDA to range from \$120 million to \$130 million, with non-GAAP EPS in the range of \$0.97 to \$1.12 per share.

Interest expense is expected to be modestly lower compared to the third quarter, while the non-GAAP tax rate should be consistent at around 26%.

In terms of cash flow, we expect the GMV growth at Acima will more than offset the cash generated at Rent-A-Center.

But as noted, we still expect to be within the full year range for our free cash flow guidance.

We are assuming a fully diluted average share count of 56 million shares for the quarter with no share repurchases assumed in our guidance.

We started this year with a very strong guide for our performance across 2024, given the momentum we started building in the back half of 2023. Despite an uneven macro backdrop, ongoing softness in demand for consumer durables and the continued stress on our consumers, I'm very pleased to see the progress we've made towards achieving our goals.

Our team will continue to focus on meeting and exceeding expectations as we finish 2024 and move into the new year.

Let's move to Slide 10 and discuss how our capital allocation process supports our strategic imperatives.

Our fundamental priority continues to be supporting growth initiatives across the company through both the merchandise that our consumers are seeking and the new capabilities that make our process more seamless and accessible. Beyond that, we're committed to supporting our dividend program, which has now been running for 20 consecutive quarters going back to pre-pandemic periods.

We expect the balance of our free cash flow this year will go towards deleveraging as we progress towards a net leverage ratio of under 2x and towards our long-term target of 1.5x.

We ended the third quarter at 2.6x, down from 2.8x at the end of the second quarter as Acima's working capital needs moderated with GMV growth shifting to low double digits from the 20% area.

We were able to fully pay down our revolver and ended the third quarter with liquidity approaching \$600 million. Thanks to the strength of our balance sheet, we should be well positioned to seize opportunities outside of those core recurring priorities, whether assessing potential share repurchases or targeted M&A, we can deploy our available liquidity to advance those goals.

As we wrap up on Slide 11, I'd like to emphasize a couple of the points that Mitch mentioned earlier.

Our mission is to elevate financial opportunity for all consumers who are underserved by traditional options. Across our business, we offer accessible and inclusive solutions to help our customers find the right fit when they're shopping for durable goods.

Whether in-store or online, we're committed to creating a seamless experience for them that also delivers incremental sales and top-tier service to our third-party merchants. And that's what we've done over the past several quarters. Both of our larger segments are growing their top line, managing risk thoughtfully and driving EBITDA and EPS growth.

As we continue to do that well it enables us to create meaningful value for our stakeholders, and we're confident that our mission and our model will continue to drive sustainable, profitable growth across the near- and long-term horizons. Thank you for your time this morning. Operator, you may now open the line for questions.

QUESTIONS AND ANSWERS

Operator^ Thank you very much. (Operator Instructions) Our first question today comes from Vincent Caintic with BTIG.

Vincent Caintic^ So first question on the Acima, the trade-down activity. So it was nice to see the merchandise sales being up, and it seems like that's all incremental. And so if you could talk about that, the economics of the trade-down business model in more detail, if you could talk about where you expect the gross margins will fall out? And I guess with the lower losses that you're expecting, does that mean that the economics of that trade down business is kind of similar to the rest of the lease business once you account for the lower losses?

Fahmi Karam^ So generally speaking, the 90-day purchase activity that's usually associated with trade down comes to us at a lower margin.

But what trade down really allows us to do, especially in this backdrop of the macro being so uncertain, and it allows us to keep GMV up and it also allows us to be a little bit more selective kind of on the bottom end of our core consumer.

As we mentioned, applications were up 25%. Approval rate was down about 60 basis points.

But if you exclude some of the staffed business that moved, most of that moved from the ANow to the Acima platform, our approval rates were actually down closer to 300 basis points.

So it really allows us to be more selective in who we allow onto the balance sheet and who we give leases to.

But it does come, as I mentioned, at a lower margin, and you saw that reflected in our gross margin this quarter, and we expect that to continue into the fourth quarter.

But as we said in our prepared remarks, it does give us the ability to get to new customers into the Acima platform. Those customers that come to us through trade down typically do exercise a 90-day buyout option, but they also have repeat business and that second and third lease that they do with us typically has better margins than the first lease.

So it's good business for us.

We're excited about having that opportunity as it's continued to trend up through the year. And as you mentioned, you start seeing some of the loss improvement as it rolls through delinquency and into the P&L. You haven't really seen that just yet just because it takes a while to go through the P&L, but you are seeing some of the headwinds associated with the gross profit margin.

Vincent Caintic^ Okay. Great. That's super helpful. And then last question, just switching over to the Rent-A-Center business. Understanding that the charge-offs were up, part of that was due to seasonality, part of that is due to the consumer.

But it was interesting to also see that RAC margins were actually up 130 basis points year-over-year.

So I'm wondering how you're thinking about sort of managing that business if perhaps maybe the higher loss content is there, but there's higher profitability in that business.

If you can talk about how you manage that.

Mitchell Fadel^ Vincent, this is Mitch. No. Thanks for the question.

It's a good question.

Because the EBITDA margins are pretty strong at Rent-A-Center.

So you're always balancing the losses with the total bottom line, balancing how much you let through to get to the enough volume to cover all the costs of running a brick-and-mortar business unlike Acima and so forth.

But -- so we're happy with the margins.

We are tightening. The losses didn't surprise us.

We expected that uptick. When you look at the year, we still expect to be in the range we've been talking about all year in that 4.5% range for the year.

But at the same time, we do have to tighten a little bit, and we're doing that.

We're being prudent. When you look at the delinquency rates, which is more the forward-looking way of looking at losses going forward, I don't know if you have it in front of you, but Page 8 on the presentation.

But they went up just like they did last year in the third quarter. The line is almost identical.

The numbers went up basically the exact same as last year in the third quarter. And as we've seen in October is a leveling off in the fourth quarter exactly what we saw last year.

So that's our peak, the 4.9% expected and so forth.

We are tightening.

But you're right, we need a certain amount of volume to keep those EBITDA margins in that 16% range.

So it's a balance, always is.

We're really comfortable with it, really happy with the overall margin.

We usually peak in the summer when it comes to the losses or the delinquency rates, especially like I just mentioned, and those have leveled off just like they did last year.

So we're comfortable where we are and still we'll still be in that range for the year and very happy with the overall EBITDA margins. And not to mention the volume.

You didn't ask about this, but I'll comment on it anyhow.

But the three quarters in a row of same-store sales at Rent-A-Center, we got competitors, quasi competitors at least, the subprime competitors, not necessarily lease-own competitors, but subprime competitors going out of business, closing stores and Rent-A-Center is doing really well. Probably getting a little of that business, too.

I mentioned in my prepared comments of how we're going after that business. Certainly some of that's more geographic with where those stores are, and you know the names that are shutting down.

So it's really a tailwind for Rent-A-Center picking up those customers.

Fortunately, on the Acima side, we weren't in any of those competitors that are closing down.

We've got competitors that have to worry about that, but we were fortunate enough to not be in any of the ones that are closing stores, closing the whole business or even just closing a big portion of the stores.

So no downside yet it's a tailwind primarily on the Rent-A-Center side, maybe a little tailwind for Acima, too, as other retailers pick up that business that Acima is in, but especially for Rent-A-Center picking up those subprime customers.

So things are going well there.

And back to your original question on the losses, we're pretty comfortable where we are and know that it's leveled off here in the fourth quarter and feel good about of course, we could tighten as much as we need to.

We can do it on an hourly basis.

So it's in our control, and it's a balancing act, but we're pretty comfortable where we are.

Operator^ Our next question comes from Bobby Griffin with Raymond James.

Robert Griffin^ Congrats on another good GMV quarter.

I guess, first, Fahmi, I wanted to just touch on the Acima segment and the EBITDA flow-through.

Is it just a matter of timing? You see the gross margin pressure, but then you get the relief later on with the skips and stolens? Or if this customer that dynamic stays, maybe it's a faster growing or stronger dollar growth business with a little bit less margin upside.

Just help us think about the moving parts there and more importantly, the timing. And I guess I'm just asking in context, could we see margins and EBITDA growth accelerate in '25 if it really is just a timing dynamic that we're seeing that's pressuring the flow-through?

Fahmi Karam^ Bobby, thanks for the question.

So yes, I would agree with your comment and your question regarding some of this is timing, specifically when you think about the trade-down activity and seeing higher 90-day buyout activity. You'll start seeing the merchandise sales go up, which we saw this quarter.

We expect that to continue into the fourth quarter, and that puts pressure on your gross profit margin. Eventually, that GMV that did come from a better credit quality consumer will be a bigger portion of the portfolio, and you'll see the loss improvement probably a couple of quarters from now.

So as we think about 2025, not that we're going to get into specifics around guidance for 2025, but our expectation is that you'll start to see some normalization of gross profit margin from where we are today. And then you'll start to hopefully see a little bit better loss number or loss rate into 2025. And that kind of puts Acima right -- from an EBITDA margin standpoint, right where we want it to be, right, in that low to mid-teens number.

So as a reminder, we just guided Q4 to be relatively flat from a charge-off basis, but also have a slight uptick in the EBITDA margin at the Acima business.

But that's the trade-off.

You allow us to grow GMV. You'll definitely have a little bit of headwinds in the near term from a gross profit, but you should see some benefit in losses in a couple of quarters.

Mitchell Fadel^ And as you mentioned, Fahmi, even in the fourth quarter, we expect to see a slight increase at least in EBITDA margin.

So it would already be starting in '24 versus just waiting until '25, which was your question, Bobby. The other thing I'd add to what Fahmi said is the repeat business side of these customers, as he mentioned, that a lot of the repeat business, once people are aware of Acima, we talk about lifetime value.

But once they're aware of Acima and they've got the Acima app on their phone and they're making their payments through the app and so forth, a lot of the repeat business ends up going to our own marketplace, where the margins are higher on our marketplace than they are when we're direct with the retailer, even if that business goes through to that same retailer or a lot of times, it's a different retailer because people don't need more furniture. They might go on our marketplace and get something from Amazon or Target or Best Buy or something like that.

And those are at a little higher margin. The underwriting costs are a little lower. Actually, on repeat business, some of the same customers, they actually pay out early at a lower rate on their second account than they do on their first account, things like that. Through the marketplace, you don't pay some of the same kind of cost that we have to pay the retailer for the product and so forth.

So repeat business is more profitable than the first time through too.

So that's the other reason EBITDA margins go up when you get more customers and the lifetime value of it.

Robert Griffin^ I appreciate that. That's helpful. And then I guess, lastly for me, I mean you guys clearly are looking at different areas of the business, franchise some more stores.

So just kind of in the context of that from a capital investment standpoint and how you view things, maybe talk a little bit about what you think the opportunity is in Mexico? Business has kind of been around the same size, profitable but not really -- hasn't really been a focus point.

So just anything there and kind of what you see the long-term opportunity to be?

Mitchell Fadel^ Yes. Good question.

As I mentioned in my prepared comments, Bobby, we see the store count being pretty well done as far as reducing the corporate store count.

We're really excited about the franchise sale we did and also excited about those stores we closed earlier this year and from the standpoint of how much of the revenue we've been able to keep as we put those accounts into the nearby stores.

So that's all been positive for Rent-A-Center.

I think when you think about Mexico, we're pretty excited. They're having a good year down there.

We talk about the EBITDA being relatively flat this year.

It's up a little bit for the year.

It was relatively flat for the quarter.

They're up for the year. The currency has gone against us a little bit down there with the peso valuation being against the dollar not being as good as it was last year.

But overall, the business is strong, and we're looking at expanding Acima down there as well next year.

So it's a great opportunity down there. And from a Rent-A-Center standpoint, I don't know Fahmi, it's \$7 million or \$8 million of U.S. EBITDA at least in a year, something like that, which isn't huge, and yes, I mean a good year is adding \$1 million.

Obviously if you had \$1 million on top of \$7 million, that's really a good year, but it doesn't move our needle.

But Acima very well could move the needle when we take that to a country as large as Mexico and so forth. So we're pretty excited about Mexico more from that standpoint of expanding a virtual platform down there than Rent-A-Center stores that are doing well if they add \$1 million a year to EBITDA or something that's, like I said, not going to make much of a difference even though we appreciate everything they do for us down there.

But Acima could be really exciting down the road there.

Fahmi Karam^ And what we've done, Bobby, this year in Mexico on the Rent-A-Center side is really the reason why we're up on a year-to-date basis is because we've gotten our losses under control.

We started to build a centralized decision engine down there. The team has done a great job in rolling that out.

It is now fully functional down there and really paves the way for us to be more aggressive next year with the Acima platform.

Mitchell Fadel^ It's the precursor is them doing -- getting the decisioning right for the Rent-A-Center business to allow Acima to then use it and tweak it and so forth.

So like I said, we're pretty excited about that.

Operator^ Our next question comes from Hoang Nguyen with TD Cowen.

Hoang Nguyen^ So granted, you said that there's going to be a lag on the benefits of the trade down on credit, I guess, on delinquency and losses down the road.

But I mean you're still seeing a tick up in loss and delinquency this quarter.

So maybe can you talk about what segment of your customers is contributing to this? And maybe what actions that you're taking to manage this group of now higher-risk customers? And I have a follow-up.

Mitchell Fadel^ Yes. Sure, Hoang. Good question. Remember, though, on the trade down we're talking about is primarily Acima and Acima losses are down sequentially and year-over-year. Rent-A-Center doesn't see the same level of trade down, not being in waterfalls within retail partners and so forth. And where Rent-A-Center went up in delinquency very similar to last year, they're not -- there's no positive impact to trade down there or if there is a positive impact from some of the other subprime retailers closing, they're still not as apt to do the early purchase option so forth.

It's -- trade down at Rent-A-Center is much different.

So the -- than it is at Acima.

So the trade down we're talking about is really at Acima and their losses are trending down in a pretty significant way when most of our -- most lenders, if you will, are going up from a loss standpoint, Acima is trending down sequentially and year-over-year.

So we certainly feel good about that. To answer the last part of your question, our capabilities from an underwriting standpoint to be able to control that.

We certainly look at that -- I mean there's people who look at it daily.

Fahmi and I look at it more weekly with Tyler Montrone, the person that runs Acima for us and certainly make any tweaks we need to and so forth.

But we're real comfortable with the trends there because their losses are actually on the way down.

Hoang Nguyen^ Got it. And maybe this one is for Fahmi.

So I saw that you guys incurred an estimated settlement expenses, \$7.5 million for all three outstanding legal matters with the CFPB, New York AG and Multistate AG.

Can you give a little bit more color around that estimate? I mean is this your estimate currently for all three issues?

Fahmi Karam^ Thanks for the question. Yes, look, I can't comment too much on the open litigation and open settlement talks.

But from an accounting standpoint, once something becomes probable and reasonable, estimable, we tend to put an accrual on the books.

It doesn't mean that's where we're going to necessarily shake out, but that was our best estimate given the number that we -- or the facts that we have in front of us at this time. And as far as some of those investigations and litigations go, I would just point you to the 10-Q that we're going to file.

We'll have updated disclosures across the board, but that's how we came up with the accrual this quarter.

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

Bradley Thomas^ Let me add my congratulations as well on a nice quarter here. Mitch, I was hoping to follow up just on the outlook for Acima and its GMV growth. A year ago, you laid out a multi-year plan through 2026 to be growing revenue in the segment by 10% to 12%. Clearly, the GMV in recent quarters has been even stronger than that.

Can you just talk a little bit about your confidence that you can be in that range as you look out to 2025?

Mitchell Fadel^ Sure. Brad, I'd love to talk about Acima's growth because it's been really strong, to your point.

We think there's many years of double-digit -- low double-digit growth in Acima coming forward.

We see -- still see an awful lot of white space out there.

We're -- as we just pointed out, we're going to -- we raised our fourth quarter comp guidance to low double digit, that's coming off a 19% last year in the fourth quarter.

So when you come off double digits, pretty -- it gives us a lot of confidence that low double digits is the number going forward for many years.

We've had an awful lot of wins on the retail side, an awful lot of positive things going on there.

We talked about trade down, but some of the wins at the retail side, it's interesting, and I get a little frustrated because there's been a lot of talk about retailer we lost, one regional retailer, furniture retailer we lost and a competitor of ours likes talking about that a whole lot, even did a press release on it. Yet we've taken over the last couple of years numerous accounts from our competition, in fact, from that same competitor that wants to talk a lot.

And quite honestly, Brad, some of the analysts write about it a lot about one regional win they had when over the last two years, we've taken Wayfair and Ashley and what else, Sleep Outfitters, Slumberland, City Furniture, Levin Furniture, that's at least six that

we've taken from that competitor in the last two years, and those are all top 100 furniture retailers.

So we've had an awful lot more wins than losses. We've led the industry in growth for a couple of years now as you know from the GMV side, and we're very confident that's going to continue.

Our sales team is knocking it out of the park, our integration for retailers is the simplest in the industry, our marketplace adds volume for our retailers like nobody else's, we've got more options than anybody else, whether they want to have a staff model or a quasi-staff model, a little bit of support from -- our sales team is the largest out there, and I dare say the best just based on the results.

So when we look at the growth, we're pretty excited about all the wins we've had and just what our GMV has been. And like I said, I get a little frustrated reading about one loss we had where -- obviously it wasn't that big a loss or we wouldn't be -- we wouldn't have upped our GMV for the fourth quarter.

But some of these other wins are more than making up for it, and there's a lot more coming from there.

So we're pretty excited about the future of growth for Acima.

Bradley Thomas^ That's helpful, Mitch. Absolutely a lot to be excited about from you all. And no question, the results have been really good.

I want to ask a follow-up just on the marketplace and wondering if you could share any more color on how big that's been. And as we look to next year, how much you think that could be contributing to the GMV growth?

Mitchell Fadel^ Well I'm glad you asked about the marketplace because we did touch on -- I touched on it in the prepared comments, but it really is exciting when you think about our new product, this AI leasability -- generative AI leasability engine, which allows us to not only onboard retailers so much faster on the marketplace.

It's like it takes 10 days now instead of 1.5 months, things like that.

So -- and the reason the onboarding used to be slow is you had to sift through their products and figure out what's leasable, and it's hard to add an Amazon onto the marketplace and make sure people aren't leasing food or something like that that you can get from Amazon, right? So with this new leasability engine, and it's working just tremendously.

Our team did a great job putting it together with a tremendous partner, as I mentioned.

And now we've added people like Walmart and Amazon and Target and eBay. And that really just went live, the leasability engine went live in the first week of October.

So that's not even in the like 30% growth we had in the marketplace in the third quarter, roughly 30%.

So really excited about it.

As far as how much it adds next year, I think it's certainly -- without getting into too many details about next year, certainly it adds -- it helps us get that double-digit -- low double-digit growth.

But if it -- on the other hand, if it works as well as we think it could, we'll be helping those numbers, too, because you just think about we're doing low double-digit growth right now comping over 19% and we're not even -- that was before we added Amazon and Walmart and Target to our marketplace.

So I guess you'd have to say when you say low double digits, it's the low end of the spectrum when you think about the -- adding those kind of names in when we're already doing the low double-digit numbers.

So really excited about the marketplace and the future of it as well.

Operator^ Our next question comes from John Hecht with Jefferies.

John Hecht^ Congratulations on all the good momentum. Actually, one of my questions was just asked, so I'll just have one question. And that's given the consumer trade-down effect happening in real time as we enter the holiday season, are there any differences that you guys expect in terms of the mix or type of transaction and how that flows through?

Fahmi Karam^ Yes.

I don't know if I would expect any real changes over the holiday season.

Obviously those five weeks are very important to us and generate a lot of GMV. And then if you think about kind of the flow into the first quarter with tax season, that's typically our highest 90-day purchase option activity anyway.

So with trade down, we probably expect to see some of that activity continue.

But as far as kind of where the GMV is coming from, price channel, new and returning customers, I'm not expecting a big shift year-over-year.

Operator^ Our next question comes from John Rowan with Janney Montgomery Scott.

John Rowan^ Just a quick question for me.

So the settlement with the CFPB that the -- whatever it was, \$7.5 million, that covers specifically the issue that they raised with Acima regarding the difficulty of returning leases and whether or not it was actually nonrecourse.

I just want to make sure that that settlement covers -- or expects to cover that specific issue.

Fahmi Karam^ So John, we don't disclose kind of the specifics.

So -- but I will say it's not just that one issue.

So it's not something we're going to disclose on which one of the issues.

It's not something we typically do.

Mitchell Fadel^ And it's not settlement.

It's an estimate that's putting money on the books to presumably settle at some point, right? So it's not like it's settled.

It's an estimate on our best estimate right now on what -- on settlement of those three issues put together.

John Rowan^ So the three issues -- so the three outstanding issues are all included in that estimate?

Mitchell Fadel^ Correct.

Operator^ Our next question comes from Anthony Chukumba with Loop Capital Markets.

Anthony Chukumba^ So I mean you've laid out your fourth quarter guidance.

I'm sure this is factored into the guidance.

But how do you think about, I guess, two things, the fact that we do have this presidential election next Tuesday and then the fact that it's going to be five fewer shopping days between Thanksgiving and Christmas?

Mitchell Fadel^ Yes. Good question.

I mean we do have that factored in, although the -- I mean November leading up to Black Friday is very strong for us as well.

So the shopping days certainly make it a little less than last year when you had -- in certain years, you're going to have the opposite effect depending where that fourth Thursday falls and all that stuff for Thanksgiving.

So -- but really leading up to Thanksgiving so strong, Anthony, it doesn't have that big of an impact, some impact, but probably a lot less impact than maybe just (technical difficulty) even Acima where they do their business off of traditional retail or at least most of their business off traditional retail.

We're probably being a little conservative because of the way the calendar falls, but the applications are so -- are up so much, like we said, 25% in the third quarter.

We just have a lot of momentum and -- but we do have that factored in. You're exactly right about that.

Operator^ That does conclude our Q&A for today. I would now like to turn it back to Mitch Fadel for closing remarks.

Mitchell Fadel^ Thank you, Operator. And thank you to everyone who joined us today for the update on the third quarter and our outlook for the fourth quarter and for the rest of the year.

I'm really thankful for the efforts of our coworkers and our merchant partners who helped us deliver an impressive quarter in a few different ways, especially on GMV. And of course, Rent-A-Center same-store sales results were also very impressive. So we're grateful to all of our coworkers for all their hard work.

We got a bunch of people working really hard for our shareholders, and it shows, and we're also grateful for our shareholders and for the interest and support of them and look forward to updating you next quarter on our continued progress towards our goals in 2025. We'll be talking about it soon enough. Thanks, everybody.

Operator^ This does conclude today's program. You may now disconnect.