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Rent-A-Center, Inc. (RCII)

Q1 2019 Earnings Call

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Budd Bugatch
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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and thank you for holding. Welcome to Rent-A-Center's First Quarter Earnings Conference Call. As a reminder, this conference is being recorded, Tuesday, May 7, 2019. Your speakers today are Mr. Mitch Fadel, Chief Executive Officer of Rent-A-Center; Maureen Short, Chief Financial Officer; and Robert Kiley, Director of Finance.

I would now like to turn the call over to Mr. Kiley. Please go ahead, sir.

Rob Kiley
Director of Finance, Rent-A-Center, Inc.

Thank you, Marcella. Good morning, everyone, and thank you for joining us. Our earnings release was distributed after market close yesterday, which outlines our operational and financial results for the first quarter of 2019. All related materials, including a link to the live webcast, are available on our website at investor.rentacenter.com.

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

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

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

Thank you, Rob, and good morning, everyone. Thank you for joining us. Before we get to our financial and operational performance, I want to address the status of our termination of the merger agreement with the affiliates of Vintage Capital.

On April 22, we reported the resolution of all further litigation of Vintage Capital and B. Riley. Under the terms of the settlement, Rent-A-Center will receive a payment of $92.5 million in cash to be paid on or before May 28 of 2019. And after fees and other costs, Rent-A-Center will retain pre-tax proceeds of approximately $80 million and approximately $60 million after tax.

Overall, we're pleased with the outcome of the litigation, and we look forward to turning our whole and undivided attention to executing our strategic plan focused on growing our business and enhancing value for our shareholders. Our plan, as evidenced by us raising our annual guidance, is working well, and Maureen will talk more about the guidance increases in just a few minutes.

Moving on to the presentation, we will be providing a voice-over to the presentation shown on the webcast. If you're unable to view the webcast, it can also be found on the Investor Relations section of our website.

So moving on to that very positive strategic update, the 2019 strategic plan focuses on three key pillars, with the underlying goal of improving the customer experience. We continue to see our strategies materialize in our performance results, whether in revenues, on the bottom line, or in our customer satisfaction surveys.

Our focus will continue to be on cost optimization, enhancing and executing the value proposition for our customers, and the execution of franchising as a means of improving operating results in underperforming markets and stabilizing our brick-and-mortar store footprint.

Our first quarter results show that many of the operational headwinds we faced last year have been largely addressed and resolved over the past 12 months. As a result, our go-forward strategies will be geared towards growing the business and simultaneously improving the customer experience.

As we progress through the presentation this morning, I'm excited to share more about what we're doing and some of the very fine results we've seen this past quarter. Starting with our cost optimization strategy, as you're well aware, we began implementing some needed cost rationalization initiatives early in 2018, and we're now benefiting from the full run rate of those initiatives.

Additionally, during the first quarter of this year, we identified incremental savings from further overhead efficiencies and other store expenses. We now project annualized savings on a run-rate basis in excess of $140 million. At the same time, we're investing some of these savings by enhancing the customer experience through improved staffing levels at the store level in order to meet the growing demand and service needs of our customers.

Turning to the enhanced value proposition pillar, we're creating a more seamless online shopping experience for our customers through technology investments. These online infrastructure investments have driven increases in web traffic and core store web agreement. These improved results together with positive customer feedback reinforced our belief that we're investing in the right areas.

Additionally, in our Acceptance NOW business, we test-launched in the first quarter a new software that we call Flash Finance, supporting our virtual unmanned and hybrid operating solutions. Now this enhancement allows us to selectively convert low-volume staff locations in the virtual unmanned stores, resulting in potentially significant labor savings. While we're in the early test stages, we feel our new Flash Finance platform has the potential to be scalable, make us more competitive in the marketplace, and put Acceptance NOW in an even better position to take advantage of the great growth opportunities available in the retail kiosk space.

Finally, we're continuing to focus on franchising. Into this end, in the first quarter, we've refranchised 37 stores in the Baltimore area, and over the past 12 months, we've refranchised over 100 locations. Looking ahead, we remain committed to our strategy of refranchising markets opportunistically. Franchising continues to be a great avenue for us to stabilize our store footprint and improve store performance across certain markets.

Now, looking at the graphs on the bottom of Slide 3, our consolidated same-store sales increased 6.8% for the quarter or 7.6% on a two-year stacked comp basis. In addition, as you can see, our trailing 12-month EBITDA was $226 million at the end of the first quarter, which again is a result of the turnaround our business has made over the past year, fueled by our enhanced customer value proposition and substantial cost-saving initiatives we started last year.

Now, looking ahead on Page 4 to just the Core segment. Driven by the execution of value proposition changes, the Core turned in a better than expected 5.8% same-store sales increase in the first quarter. And when you consider our comp is now driven principally by having more customers and we don't have the easy collect-more-of-our-own-money benefit that we saw in the second half of last year, this comp is really quite impressive.

Additionally, the changes we have made have driven lower product returns, higher retention rates, and higher customer satisfaction. I should also mention that the delay in tax returns in the first quarter caused some shifting of payouts within the quarter, but overall payouts in the Core segment were in line with our expectation, and we didn't experience any negative impact from the brief delay.

Deliveries and customer growth both trended higher than last year. And as a result, our portfolio, on a same-store comp basis, finished the quarter approximately 4.5% higher than last year and is a key reason for raising our full-year 2019 guidance. We've talked about this before. This is a metric with the -how the portfolio compares the year before is the metric that's a great leading indicator for future same-store sales expectations. And we went into the year about 3% ahead of last year year-over-year, and ended the quarter at 4.5%, roughly 4.5% higher than last year. So, good – a good quarter in a lot of aspects.

Finally, web-generated agreements were up 33% year-over-year, and we saw similar increases in our web traffic and web orders, both of which are significant delivery in new customer drivers. And speaking of customer drivers, if you're looking at Slide 4, the bottom-right-hand corner, you can see our customer per store average at the end of the first quarter is the highest it's been in four years – all four years around that chart. So we're pretty proud of that. And it's a pretty impressive job the team has done to get our customer count to the highest level per store in the last four years.

Equally impressive in the quarter were the bottom line results. Adjusted EBITDA was $27 million higher than the first quarter in 2018, primarily driven by the cost-saving initiatives and store rationalization.

Now, moving on to Acceptance NOW, while we saw similar results, as our changes to the value proposition drove a same-store sales increase of 10.1% for the quarter, and although our portfolio ended the quarter slightly lower than expected due to the – some higher than expected payouts in this segment on a comp basis, the portfolio was higher than last year by almost 17%, putting our same-store sales projections on the strong trajectory.

Invoice volume on a per-store basis continued to climb, as the first quarter was up 27% over last year. Adjusted EBITDA was $22 million for the quarter, $2 million or 90 basis points better than last year. And with the merger litigation now behind us, as I mentioned a moment ago, we can now increase our focus on investing in software enhancements, creating greater growth opportunities, and cost optimization within this segment.

In other words, we can now take Acceptance NOW to the next level, now that the merger and the litigation is behind us. And as these – growth efforts pertaining to Acceptance NOW progress over the next couple of months, we look forward to giving you an updated outlook for what our growth outlook is in this segment. So, more to come on that.

With this one, I'll turn the call over to Maureen for highlights on our financial results.

Maureen B. Short

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

Thanks, Mitch. Good morning, everyone. I'll cover some financial highlights for the first quarter and provide an overview of our balance sheet and cash flow. I will then close with our revised guidance for 2019 before opening up the call for questions. Our first quarter performance is slightly better than our internal forecast, free cash flow is better than expected, and additional cost-savings were identified and implemented.

Consolidated total revenues were approximately $697 million during the first quarter, flat versus the same period of last year, primarily driven by a consolidated same-store sales increase of 6.8%, offset by closures of certain Core U.S. stores and refranchising over 100 locations. Adjusted EBITDA was $66.5 million in the quarter and EBITDA margin was 9.5%, up 590 basis points over the same period last year.

Net diluted profit per share, excluding special items, was $0.59. The special item charges taken in the quarter were $33.4 million, primarily driven by the Blair class action litigation settlement, legal and advisory fees related to the merger agreement termination, cost savings initiatives, and store closures.

In our Core segment, total revenues in the first quarter decreased 1.7% versus the same period last year, primarily due to refranchising and the rationalization of the Core U.S. store base, partially offset by a same-store sales increase of 5.8%. Store labor and other store expenses decreased by $37.4 million, primarily driven by lower store count and cost-savings initiatives.

Skip/stolen losses in the Core were 3.7% of revenue, which was 60 basis points higher than the same period last year. Adjusted EBITDA in the Core segment was approximately $67 million and EBITDA margin was 14%, which was up 570 basis points versus the prior year.

Now turning to the Acceptance NOW business. Same-store sales increased by 10.1% in the first quarter while total revenues were flat primarily driven by store closures in 2017. Store labor and other store expenses decreased by $4.6 million, primarily driven by cost savings initiatives. Skip/stolen losses for Acceptance NOW were 10% of revenue, which was 110 basis points higher than the same period last year.

Adjusted EBITDA in the Acceptance NOW segment was approximately $22 million, and EBITDA margin was 11.3%, up 100 basis points versus last year. Mexico grew revenue by 10.9% in the first quarter and generated $1.4 million in adjusted EBITDA.

In the Franchise segment, revenue increased by 83% in the first quarter, primarily due to the success of our refranchising initiatives with over 100 refranchise locations versus prior year. Adjusted EBITDA was $1.8 million, representing an increase of 39% versus prior year. Corporate operating expenses in the first quarter decreased by approximately $12 million due to the rationalization of our cost-savings initiatives.

Moving on to the balance sheet and cash flow. For the first quarter of 2019, cash generated from operating activities was $76 million, $9 million lower than the prior year, driven by higher inventory purchases and working capital, offset by stronger operating performance. We ended the quarter with $238 million in cash on the balance sheet and reduced net debt by $82 million in the quarter.

Total available capacity on our revolver at the end of Q1 was approximately $95 million, taking into account our committed letters of credit and reserves. Total liquidity, including cash on hand, at the end of the quarter was approximately $333 million. The company's net debt to adjusted EBITDA ended the quarter at 1.4 times, significantly reduced versus the ratio of 2.1 at the end of 2018.

Over the next few months, we intend to refinance our balance sheet and aggressively de-lever by utilizing excess cash to reduce our debt balance and extend our debt maturities in a longer term facility. We expect the new debt facility will give us more flexibility on capital allocation, including dividends, debt repayments, and share repurchases. The company is reviewing capital allocation priorities. Given our cash position at the end of the first quarter and the settlement from the termination of the merger agreement, we are in a strong position to refinance and extend the upcoming debt maturities.

As you look at Slide 9 in our presentation, it lays out our latest expectations for 2019. Total consolidated revenue is expected to be in the range of $2.585 billion to $2.630 billion. While our consolidated revenue is unchanged from the previous guidance provided on the Q4 earnings call, the Core revenues were increased by $25 million due to the strength of our Core portfolio and Acceptance NOW revenue was reduced by $25 million due to the higher-than-expected payouts in the first quarter and the planned conversion of some staff locations to virtual locations.

Adjusted EBITDA is now projected to be between $230 million and $260 million, as we benefit from improved leverage do the full-year benefit of our cost-savings initiatives. Non-GAAP diluted earnings per share are expected to be between $1.85 and $2.25. Adjusted EBITDA increased $10 million and EPS increased $0.10 from the previous guidance due to the performance in the first quarter and incremental cost-savings initiatives identified and expected to be implemented in 2019. The settlement from the termination of the merger agreement will positively impact GAAP earnings but will be treated as a special one-time item.

Free cash flow is expected to be between $195 million and $225 million, an increase of $80 million from the guidance provided on the Q4 earnings call, primarily due to the proceeds from the merger termination settlement and our better-than-expected first quarter results.

Cash taxes are now expected to be between $35 million and $40 million, up $25 million primarily due to the settlement. As I mentioned, the company is in active discussions with our bank group and expect to refinance the balance sheet during 2019. However, today's guidance does not include the impact of refinancing. Additionally, the guidance does not include any new REIT franchise transactions after the first quarter of 2019.

Thank you for your time. Now we'll turn the call over for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Brad Thomas from KeyBanc Capital. Your line is open.

Bradley Thomas
Analyst, KeyBanc Capital Markets, Inc.

Q

Hi, good morning.

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

A

Good morning.

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

A

Good morning, Brad.

Bradley Thomas
Analyst, KeyBanc Capital Markets, Inc.

Q

Congrats on the strong start to the year here. I wanted to ask a couple of questions just about the refranchising efforts. And for one, Mitch, I was hoping you could just give us an update on how those conversations are going. And then I was hoping you could just remind us all how to think about the economics as it impacts the P&L from a refranchise store versus a store you owned. Thank you.

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

A

Well, sure. As you know, Brad, we are using franchising as a means to, number one, stabilize our brick-and-mortar footprint, and also help performance in – improve performance in the underperforming markets. So we're doing it opportunistically in certain markets to stabilize the footprint, like I said, and to help in some underperforming markets where possibly a franchisee can do better than us, but we'll only do these deals if they benefit us financially.

When you – when you asked about the impacts to the P&L, there can be some EBITDA drop. The royalty may be lower than the profit we're making in the store. In some cases, it might even increase it. But you've got to compare that to what you're getting upfront for the stores. We only can do it if the right return on investment is there. And if the EBITDA is going to be down going forward, we're going to have our money upfront and be able to reinvest that money anyhow.

So, only if the numbers work for us are we doing the refranchising. So I wouldn't – when we think about the fact that it's not in our numbers going forward, that doesn't trouble us because we're only going to do them if they benefit the numbers going forward in one way or the other, either through increased EBITDA or the return on capital by – if the EBITDA is going down but you've got – I don't know – eight times that, 10 times that amount upfront, that you can reinvest, it's going to help us on our return. So...

Bradley Thomas
Analyst, KeyBanc Capital Markets, Inc.

Q

Makes sense. And just at a high level, as we think about the 100 some odd stores that you've done thus far, when we think about the EBITDA impact going forward, is that a group that's collectively having refranchised them and getting the fees in there? Is that a [ph] group flexibility (19:39) where EBITDA is higher for you all going forward because of that or whether the EBITDA goes down and you've gotten the proceeds from it? I'm just trying to think about kind of is that a headwind or a tailwind to your EBITDA run rate.

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

A

Well, those are already in our guidance going forward, the ones we've already done. And they were pretty de minimis impact on EBITDA. They were underperforming stores. So the EBITDA impact – most of everything we've sold have been underperforming stores. So the EBITDA impact of just the royalty stream compared to the EBITDA we are making, there is some difference in there, but it was pretty small in the scheme of things, pretty de minimis. And relative to the money we received upfront, it was a very positive return on capital – return on investment.

Bradley Thomas
Analyst, KeyBanc Capital Markets, Inc.

Q

Great, great. And if I could squeeze in one question just around your comments on the FTC, I guess just, for one, could you just give us an update? Is that the only letter that you've received from the FTC at this point? And I guess any more color around that would be helpful.

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

A

It is. We've got a civil investigative demand from the FTC, like it says in the press release. They are requesting information relating to purchases and sales by us to other rent-to-own companies' customer accounts. And we are in a process of responding to the inquiry. And I think it's important to say we do believe these transactions are transactions we made were in compliance with the FTC Act. So we'll reply and respond accordingly, but we believe our transactions were fully in compliance with the FTC Act.

Bradley Thomas
Analyst, KeyBanc Capital Markets, Inc.

Q

And Mitch, any context for us on maybe what percentage of your transactions you tend to, in a given year, sell to another rent-to-own company, just so we could size up what they're looking at here?

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

A

No, I don't have that in front of me. We haven't done any in a few years. I mean, this goes back a few years. It's not a lot of stores. I don't have the number in front of me. And it has [indiscernible] (21:45) in the last couple of years. We haven't sold any stores to a competitor like that. And then when we did, it was a few stores here and there. So it's – it's not a very big number in the scheme of things.

Bradley Thomas
Analyst, KeyBanc Capital Markets, Inc.

Q

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

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

A

Thanks Brad.

Operator: Your next question comes from the line of Kyle Joseph from Jefferies. Your line is open.

Kyle Joseph
Analyst, Jefferies LLC

Q

Hey, good morning. Thanks for taking my questions and also congratulations on a strong start to the year. I wanted to focus a bit on Acceptance NOW. Given the improvements you've seen in invoice volume, the investments you've made in that business, can you give us a sense for your outlook in terms of the balance of manned versus unmanned kiosks in that business and also the long-term growth opportunity in your mind?

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

A

Sure, Kyle. As I said, we're – we're pretty excited about taking Acceptance NOW to the next level with this – with the new software, being able to offer a manned location and an unmanned location with this very competitive software, a hybrid of such. Maybe some days we're manned, some days we're unmanned. But we are still in the testing stage of that, still quantifying that growth opportunity, and we don't have any – we haven't put anything in our guidance yet from a growth standpoint. And we do feel there's significant – I think everybody knows there's significant whitespace there and we're committing to growing in that space.

Over the next couple of months, we're going to put that plan together. Again, now that the litigation is behind us, we're going to put that plan together, what's it look like over the next three years or so, and what do we think the growth can be and so forth, and get back to – get back to our folks or stockholders on what we think that plan is. So more to come on that. We're excited about it. We're working on it. And like I said, in the next couple of months, we'll show you – we'll quantify that for you as far as what that growth plan looks like.

Kyle Joseph
Analyst, Jefferies LLC

Q

Got it. And then just talking a little bit focusing on seasonality, obviously there's some – there's a lot of moving parts with cost cuts and whatnot. But just – I guess, first, from a G&A perspective, is the first quarter a decent run rate? I know you said you've identified some additional cost cuts. And then second part of the question would be, can you give us a sense for the seasonality of EPS contributions in 2019 just from a high level, given all the moving parts?

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

A

Yes, Kyle. The G&A in the first quarter is a good run rate. We've achieved a lot of the cost savings initiatives that we implemented in 2018 and are now comping over those that have been implemented. And as we mentioned on the call, we did also implement additional incremental cost-savings initiatives towards the middle of the quarter in 2019 in Q1. And so there may be a little bit more, but essentially the G&A is a good run rate going forward.

And then your question about seasonality, yes, we're back to – now that we're through the turnaround, we're back to historical seasonality periods, where in the first quarter, given tax refund season, we tend to see higher revenue, higher earnings. And then typically in the third quarter, we see a little bit lower revenue and a little bit lower earnings, but for the most part, we said we're through the turnaround, we're at a good run rate as far as what we expect to continue to grow from going forward. So, back to historical levels of seasonality.

Kyle Joseph
Analyst, Jefferies LLC

Q

Got it. One last one for me. Maureen, I know you gave the cash taxes for 2019. But modeling for the business on a Core basis going forward, can you – it looks like the tax rate was a little bit lower than we've forecasted in the first quarter. What's your long-term outlook there?

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

A

Yes. For the tax rate, we still expect it to be within 22% to 23%. And so the run rate from the first quarter is pretty similar to what we expect throughout the year. The cash taxes went up, as you saw, mainly driven by the settlement but also a little bit higher pre-tax income.

Kyle Joseph
Analyst, Jefferies LLC

Q

Got it. Thanks very much for answering my questions.

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

A

Thank you.

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

A

Thanks, Kyle.

Operator: Your next question comes from the line of Budd Bugatch from Raymond James. Your line is open.

Budd Bugatch
Analyst, Raymond James & Associates, Inc.

Q

Hello, good morning. A couple of questions if I could on Acceptance NOW. I know you were talking a little bit about – Mitch, about the manned and unmanned. What – can you give us a little bit more color on when Flash Finance starts to have an impact and what the store count might be at the end of 2019?

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

A

I think – we'll be testing here the next couple of months going into -expanding the test, we're in the process of expanding the test now. It's working pretty well, and we're in the process of expanding the test. The store count, of course, year-to-date is down a little bit from some store closures. We've forecasted a few of the lower performing stores out of the store count for this year to convert to flash. That's part of the reason the revenue is down because the virtual will do a little less revenue although more profit because you get the saving to the labor.

So I think – and I don't – I don't have what's in our model at the end of the year. We really haven't done much of the model with flash as far as forecasting. What it can do for us in the growth, we're still in the testing phase.

Listen, I'd just say it again, in the next couple of months, we'll be coming back to you with a plan, not only for the rest of this year, but for the next couple of years on where we see the store count growing to.

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

And what's the average term right now? I know you were sure, you were contracting that to get to increase the incidence of ownership. How does that look right now, as all invoice volume on a same-store basis up 27%? What does the – what's the tenure look like?

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

I'm sorry. What's the – what's the what?

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

It's the term. What's – how long – what's the length of the term of the agreements on average now...?

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

The average term – the average term of Acceptance NOW right now is running about 15 months. So we vary between 12 and 20 depending on the product. But the average is about 15 months. So we've really shorten that term as probably half of what it was a few years ago, which has really reduced the returns, increased the ownership, and the returns coming back in the Core business are under 10% now out of that business. So it's really impacted the business in a very positive way.

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

And what's the incidence of 90-day there? If returns are under 10%, that's terrific. What's the incidence of 90 days?

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

I don't have it front of me. It's probably in the – it's probably in the third – a third of the customers. In that range – about a third of them. And then a few returns and a few losses and then the rest are doing the EPO somewhere later in the agreement. But it's probably in that 35% range.

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

Got you. I was interested on – see, the Core portfolio up about 4.5%, inventory on rents actually up about 6%, and the inventory per average store, as we calculated, up about 16%. Can you kind of tell us how to think about those three statistics? How do we think about that when we model going forward?

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

Well, Well I think the – the portfolio at the end of the quarter being up 4.5%, the inventory up about 6%, those are kind of in line. I mean, they're never going to be right on top of each other. For a variety of reasons, the portfolio is a monthly snapshot of...

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

Right.

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

...snapshot of all the agreements combined, whereas the inventory on rent is the total value left. So they're never going to match perfectly based on the age of the product in that – in the inventory on rent and the balance sheet and all that. So those are – I'd say those are significantly the same number, 4.5% and 6%. And then what was the third number?

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

Well, if you calculate the inventory on rent per average store, it's up about 1,000 basis points better than the gross inventory on rent, which would indicate that comp store sales should be somewhere above the portfolio growth. Is that the way to think about it? How would you think about?

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

No, I would – I would think the – the portfolio being up in the neighborhood of 4.5% is a way to think about comps – same-store sales in the quarter going forward. Now, the portfolio on Acceptance NOW in Mexico, certainly smaller contributors, but Acceptance NOAW is a decent size contributing the overall comp. Those are higher than 4.5%, where those portfolios are compared to the year before. But – so I think it's the portfolio is how I think about same-store sales. As far as comparing the inventory on rent, again, because the age is so much different, we've got a lot more newer product in our stores than we did a year ago based on the fact there's more ownership happening with the customer base and the changes of value proposition.

So when you have newer merchandise on your balance, you're going to have a higher – you're going to have higher value in that new merchandise than when it's older merchandise like it was a year ago. So I wouldn't – I wouldn't try to put those two together. I never have because there's – you get so many variables in the age of the product.

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

Okay. I understand that. And last for me, just talk, Maureen, if you would, about the refinancing. When do you think that will be done? What we see a charge on that in – on the – as a special item? What's the thought process there?

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

Yes. So, Budd, we plan here in the next few months to refinance and aggressively de-lever the balance sheet and roll the excess cash flow into that debt balance. As far as the fees and associated expenses of the refinancing, none of that's been forecasted into our plan. But there will likely be one-time fees or one-time items that are associated with the refinancing.

Budd Bugatch
Analyst, Raymond James & Associates, Inc.

Q

Do you think you'll get the refinancing done by the end of Q2?

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

A

I would say, between the end of Q2 and in a month or so or a few weeks after that. It should be towards the end of this summer if everything goes as planned.

Budd Bugatch
Analyst, Raymond James & Associates, Inc.

Q

Okay. Thank you very much. Good luck on the quarter and the balance of the year.

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

A

Thank you.

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

A

Thanks much.

Operator: Your next question comes from the line of John Rowan from Janney. Your line is open.

John Rowan
Analyst, Janney Montgomery Scott LLC

Q

Good morning.

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

A

Good morning.

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

A

Good morning, John.

John Rowan
Analyst, Janney Montgomery Scott LLC

Q

Good morning. Just to go back to the refinancing, are we talking about recalling the two notes and refinancing into new notes, or are you refinancing into a revolving facility and then getting rid of the notes? And – are the notes callable? I'm trying to – I mean, I could look it up, and I'm trying to figure out and size up what could be one-time cost?

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

The notes are both callable after the 15th of May, I believe is the date. They're both callable at par. We have not determined yet or finalized the decisions around the capital, the refinancing. But we do plan to have a longer term debt facility that will provide us the appropriate liquidity to be able to make investments in the business and also contemplate any capital allocation priority changes that the company may establish going forward.

John Rowan
Analyst, Janney Montgomery Scott LLC
Q

Okay. And then just to size up, just [indiscernible] (34:02) with your free cash flow guidance, I just want to make sure, it seems like you're going to pay, I would say, $25 million in cash taxes for the quarter, largely because of the gain in 2Q from the settlement. I was just trying to make sure, does that insinuate that maybe the DTL will be down about $10 million year-over-year in 2019? I'm just trying to make sure I have that number correct.

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

I would have to look at that piece that we did raise the cash flow (sic) [taxes] guidance by $25 million for the full year. But yes, most of that is related to the second quarter tax impact of the settlement.

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

The cash...

John Rowan
Analyst, Janney Montgomery Scott LLC
Q

Okay. Would you expect the DTL to trend down though through the year?

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

Partially, yes, because part of that was based on the pre-tax income impact of increasing our guidance. But John, we can follow up afterwards to talk through the deferred tax impact.

John Rowan
Analyst, Janney Montgomery Scott LLC
Q

Okay. Thank you.

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

Thanks.

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

Thanks, John.

Operator: Your next question comes from the line of John Baugh from Stifel. Your line is open.

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

Q

Thank you. Good morning, and job well done. Congrats. I wondered if we could take – talk about the Core business for a second. Can you tell me where we are in staffing of the stores. You've been reducing, now you're growing. What's roughly the model you're settling on there?

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

A

Yes. Good question, John. The – glad to clarify that to the – we didn't change. When I say we're investing more in labor, we've really focused on – let me go back. We – the staffing model is what we used to use. We've gone back and got rid of the part-timers, got rid of that part-time model and gone back to full-time staffing model, not necessarily adding to it when I say we're adding – we've added some costs. So we've just focused on filling vacancies faster.

For instance, a year ago, when you look at 2,000 stores, at any point in time, there were 700 or 800 vacancies based on turnover in the stores and we've – with the help of our human resource folks, we are filling those so much faster now that in the Core business we're averaging more like 300 vacancies because we're filling them so much faster.

So when we look at our labor cost in our modeling, we – because we have less vacancies, which is a good thing, and helping the business, we've had – it's actually costing us a little more to stay closer to our staffing model that we want to be at rather than a vacancy. So it's more a matter of we've done such a good job filling vacancies faster that we've had to add money back into the forward looking model from a cost standpoint. It's not – not so much we've changed our staffing model again, and so we've done a better job staffing the stores faster when we have turnover. And therefore, there's some extra cost there. But certainly benefiting this.

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

Q

And then my last question on the Core business is really – maybe we could look at three years to five years. What is your thought about [ph] because you're (37:28) closing stores and franchising? So there's clearly a revenue decline. Your comps are positive. I assume, of course, the stores you sold as well a franchise are taking out of the comp. So if you could give any color on what that positive influence might be, that will be helpful. But I'm more interested in where the plane is three to five years, is it to continue reduce store count and franchise aggressively such that revenue will decline and you try to hold on to a percentage margin? Or is there plan to stabilize revenue and grow? And if so, how? Thank you.

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

A

Well, we think that with the fantastic growth we're – on the web, in our web orders, over 30% web visits being up in the first quarter, orders in the 30% range. Like we said, web agreements up 33%. I think our web business in the quarter is up over 11% now overall. So that continues to grow.

So we've got some great growth tailwinds in the quarter. We will refranchise opportunistically, like I said. We're not really – we're not really shooting for a number as much as we're just shooting for opportunistically being able to help turn underperforming markets around and maybe franchisees can do better or probably can do better in our underperforming markets.

It's more of a way of stabilizing our store footprint rather than continuing to close stores, because if we can refranchise them and franchisees tend to – and in our Franchise agreements, when we sell these markets, they have to maintain a certain level of store count. Whether they close stores or open stores, they have to maintain the certain level. So it's a way of stabilizing the footprint and not dropping overall stores the way we have over the last three or four years. So stabilizes the footprint will be done opportunistically. And what we've seen so far is – I mean, our revenue is pretty flat year-over-year in the Core, even with store closures in some being out of the hundred stores or so we've refranchised because the stores were keeping or making up for that revenue. Plus we've got the franchise revenue coming in and royalty.

So – I wouldn't forecast our revenue going way down because we've got the same-store sales to help offset any sales we do do, and then we've got the royalties coming in from those. And again, we're going to do that opportunistically to stabilize the footprint rather than keep going down 100 stores or 200 stores a year. Although I think we're pretty much at the end of store closures anyhow, we've got the footprint pretty much down to where we can stabilize and we'll just look at franchising the some underperforming markets.

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

Q

Okay. And then a quick question on A NOW. Could you talk about what verticals are so strong or you probably don't want to talk about individual customers. But obviously, a few retailers left, but what remain seemed to be fairly vibrant. Any color there? Thank you.

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

A

Yes. I'd say on the – we're primarily in the furniture space right now because we've been primarily just a manned model and in the volumes high enough in some of the larger furniture stores to do that. So the furniture business has been vibrant. It's been a great vertical. It's doing well. You can tell that in our numbers as well. I think there's a lot of verticals for us to get into.

Now that we're going to have the unmanned software, and there's other verticals that people are in that we're not in, like auto and – obviously there's some electronics business to do, more appliance business to do, but there's – there's auto business out there, there's eyeglass business and so forth. So there's a lot of verticals for us to get into, as we've put our re-invigorated growth plan together for Acceptance NOW. But so far, it's pretty much been in furniture, and it's been obviously very positive if the furniture business is out there.

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

Q

Does your store count in furniture growing stable, shrinking? And I'm just curious, what's driving such a strong comp there?

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

A

The store count, as you see in the press releases, is down a little bit. Again – we've been – of course, through the strategic review process, we haven't been trying to grow it. So all you have is some – all you have is some underperforming stores closing. So the store count is down. Of course, you go back to the 2017 where [indiscernible] (42:14) and we still have some headwind from there as far as revenue comping year-over-year, not in that same-store sales, but in the overall revenue – from an overall revenue standpoint. So you got – by not really focusing on growth because of strategic review process and then the litigation, all we've had is underperforming closures. So, now we're turning that corner plus with the Flash Finance software to put a growth plan together, and we'll start to see that go up the other way and come back to you with our forecast on that over the next couple of months.

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

Q

Thanks. Good luck.

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

A

Thanks, John.

Operator: Your next question comes from the line of Anthony Chukumba from Loop Capital Markets. Your line is open.

Anthony Chukumba
Analyst, Loop Capital Markets LLC

Q

Thank you. Thanks for taking my questions. So my first question is on the skips and stolens. We were up in the Core business, not so in Acceptance NOW. If I recall correctly, I think they might have been both up last quarter as well. Is there any concern that the skips and stolens are increasing? And then you obviously – the comp stores are increasing, your portfolio is getting bigger. But is there any concern that some of those increases are at the expense of suboptimal credit decisions?

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

A

Yes. Good morning, Anthony. Now – it's certainly something we're always going to watch closely. We're always watching our collections closely. But no, I'm not concerned about it. When we think about losses, we think of losses – skip/stolen losses in a range. And with the Core at 3.7% in the first quarter, that's within a range of what we'd like it to be. It's at the high-end of the range we want to be. We want to be 3% and – between 3% and 4%. So 3.7% being on the higher end. Last year, we were on the lower end at 3.1% in the first quarter. This year we're on the higher end at 3.7%. But it's within our range.

We've had a lot of growth. So it's not surprising we'd be at the top end of the range. We think, as we generate more and more out of the web, we – it's not surprising that we'd be on the higher end of our range with web agreements being slightly more risky than a walk-in customer. So we're not out of our comfort zone at all, to answer your question.

On the A NOW side, the 10% is actually the second best first quarter we've had in the last four years. Just last year was fantastic at that 9% range. So, again, that's within our range. The range in Acceptance NOW has been a 9% to 11% range, as we think about where we – the way we calculate losses and the way we account for losses, their range has been 9% to 11%.

Just last year, we were in the low end of it. And again, first quarter, there was a little bit towards the higher end of the range, but last year was really the outlier in Acceptance NOW that it was so good. So, no, in either case are we concerned about it. We'll watch it close. We'll watch our credit closely every day, how we're collecting our money and so forth. But both of those were higher than last year, higher in the range, but within our range. So it's – we're not out of our comfort zone there.

Anthony Chukumba
Analyst, Loop Capital Markets LLC

Q

Got it. That's really helpful. And then my second question, you talked about your new unmanned software – your new software Flash Finance. I guess I was just wondering, what are the primary sort of improvements or differences between your existing software and Flash Finance?

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

A

A good question. The biggest difference is Flash Finance can be done without our employee assistance. The customer or a sales associate can get through it very easily five or six steps. And – whereas our current software takes our employee assistance really to get through it because it's built to be employee-assisted, just like we use in our Core business. So this can be done without our person being there either just directly by the customer or with – by a sales associate, and not need to be employee-assisted. That's the biggest difference.

Anthony Chukumba
Analyst, Loop Capital Markets LLC

Q

Got it. That's very helpful. Thank you.

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

A

Thanks, Anthony.

Operator: Your next question comes from the line of Carla Casella from JPMorgan. Your line is open.

Q

Hey, guys. It's [ph] Sarah (46:36) on for Carla. You talked about refinancing. What do you think is the right level of leverage before you do so? And then, would you guys ever consider rolling up the two tranches of that into one larger tranche? I think they're both trading at prior calls.

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

A

Yes. So, as we think about the refinancing, we're talking through target leverage ratios, capital allocation policies, and a number of different items. And we'll be coming back in the coming weeks as we finalize those decisions with more color around target leverage ratios and things of that nature.

Q

Okay. And then, can you just repeat what the cash portion is and the timing of the termination fee?

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

A

The termination fee was a payment of $92.5 million. Netting against some fees was pre-tax proceeds of $80 million and after-tax proceeds of $60 million.

Q

Okay. Great. Thanks.

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

A

Thank you.

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

A

And timing is on or before May 28.

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

A

Right.

Q

Awesome. Thank you.

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

A

Thank you.

Operator: There are no further questions at this time. I will now turn the call over to Mitch Fadel for closing comments.

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

Well, thank you, everyone, for your time this morning. Thanks for your support. We enjoy reporting these kind of numbers. It's fun to report good numbers and raise your guidance. And we're working hard for everyone, our coworkers and ours shareholders, all our stakeholders. And it's showing up in our plan. And we are having fun, working hard, and glad to put good results on the board. And we'll just keep doing it. We'll go back to work, and we thank you for your time this morning.

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