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Rent-A-Center, Inc. (RCII)

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MANAGEMENT DISCUSSION SECTION

Kyle Joseph
Analyst, Jefferies LLC

Good afternoon and thank you for joining our fireside chat today. My name is Kyle Joseph and I'm a part of the specialty finance research team at Jefferies. Along with my colleague, John Hecht, we cover the consumer finance space. I'm pleased to have with me today the management team of Rent-A-Center including its CEO, Mitch Fadel; and its CFO, Maureen Short.

For those not familiar with the story, RCII is a leading provider in the lease-to-own industry. The company operates in three primary segments, the Rent-A-Center business which is 2,100 stores in the US and Mexico along with the e-commerce platform. The second segment is Preferred Lease, the company's virtual lease-to-own segment, reflecting the combination of Acceptance Now and Merchants Preferred. And lastly, Rent-A-Center Franchisees, which includes 370-plus franchise stores.

With that, I'll turn it over to the Rent-A-Center team to introduce themselves and the company before we kick off to Q&A. And, sorry, one last thing, for those on the webcast that have questions, if you just type your questions into the webcast, I can pass those along to management for you.

Thanks, guys. And I'll turn it over to Rent-A-Center now.

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

Thanks, Kyle, and good afternoon, everyone. It's Mitch Fadel. I'm the CEO of Rent-A-Center. I'm joined by our Chief Financial Officer, Maureen Short, this afternoon. A little brief overview to start before we take some questions, high-level overview, of course, update with the pandemic. Kyle went through the three different segments we have, focusing on the bigger ones like Rent-A-Center and then our retail partner business, in this update, we – back at the beginning of May was the last time when we reported our first quarter. We put out guidance for the second quarter. There's still a lot of uncertainties in the first week of May.

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So, pandemic have been going for a while but there's some still quite a bit of uncertainty, still had some stores that weren't fully opened and so forth. And we said then that we thought the revenue would be 10% or less drop from 2019, so not a huge drop. That was considered good news by most investors. And even better EBITDA would only be 10% or less compared to 2019. And it's really a sign of our recession-resilient business model. I'll talk more about that as we go here in the next 20 minutes or so that we don't have the same drop that maybe traditional retail has.

So we – so pandemic comes, we were in household furniture goods at Rent-A-Center and in our Preferred Lease retail partner business. So it's been good as all of you know for household furnishings. People spend more time in home. Money's coming out of other [ph] technologies (00:02:51) like entertainment, travel and so forth. So it's been good for us. And it's good for us because it's a lease and not a sale, in that the customers not taking on debt, there's a lot of flexibility. If they can't afford it, we just pick it up and rent it to somebody else. So, the business model works, really outperforms in a recession. And in this case, more of a homebound recession is even better for our business model.

So, business has been good. We've put out a couple of press releases saying that demand remains strong and our portfolio performance has been strong. And when I say portfolio, I'm talking about there's demand coming in in the portfolio holding and building, so we're not getting a tremendous amount of returns or anything like that. There's demand on the front end and people are keeping it because when – in a lease-to-own transaction, when customers make their payment, they're deciding every time they make their payment to keep the product longer. So that's – when demand is strong on the front end so is demand on people deciding to keep it because they want these things in their home.

So overall, the portfolio has performed well, better than we expected, the last time we put out our press release. So, it's been better. Not surprising to us, there's a lot of uncertainty when we put out our second quarter guidance, if you will, or at least ballpark guidance, what we thought might happen. And as we've said a few times, it's been better than we expected, especially in the Rent-A-Center side.

On the Preferred Lease side, that's a retail part of business and about 80% of our locations are furniture related. So a lot of them were closed as compared to being able to stay open. Rent-A-Center stores, most of those were able to stay open even through shutdown orders as an essential business because of appliances and computers.

So, furniture stores, most of the Preferred Lease, 80% or so of the Preferred Lease partners being in furniture, a lot of those did close. So the portfolio dropped. We had great recurring revenue. That's the benefit of having recurring revenue model. Didn't get a lot of returns [indiscernible] (00:04:48) people wanted the stuff, but we weren't able to add in to the portfolio for a number of weeks. And now, virtually, all of our stores and retail partners are open, albeit, just a handful.

And as most of you know, the demand for home furnishings as these business reopens has been tremendous and good for us. Portfolio is coming back very strong. Lenders above us – consumer lending above us is tightening. So it's good for us and the portfolio is coming back very strong. So, I'd hate to say that anything good about a pandemic that is unfortunate. It touched so many people and so many lives so negatively. And so our hearts and prayers go out to anybody affected that way.

Our big focus is on safety and operating our business as well. And we never want to forget that. It has from a business standpoint has – there's a lot of positives when it comes to lease-to-own household furnishings through this pandemic. And we see it going on for quite a while, Kyle, as far as the benefits of it as we go in a recession,

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credit tightens up. We've always outperformed in a recession. I've been through quite a few recessions as you could tell from – I don't know how many people can see me, but [indiscernible] (00:06:01) long time, and we [ph] performed along (00:06:04) a recession. And this one's even a better type recession for us because it's got people staying home longer and we see a lot of tailwind in it. So, we're very optimistic about our future and the business has been stronger than we expected when this thing started up to now. And we're very optimistic about our future.

So, Maureen, anything to add to that? [indiscernible] (00:06:27).

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

I don't want to be redundant, but, yeah, we're very pleased to be in the rent-to-own industry during times like this.

QUESTION AND ANSWER SECTION

Kyle Joseph
Analyst, Jefferies LLC

Q

Yeah. That's very helpful. Thanks. And I'll kick off Q&A now. Let's go segment by segment. We'll start with the Rent-A-Center segment. 2020 has been quite an eventful year. I kind of think about it in three phases already. We had the pre-COVID era through mid-March really; mid-March to mid-April, we had the economy and society essentially shutdown for that matter; and then post mid-April, as the economy starts to reopen along with stimulus and federal unemployment. So, can you just walk through how the Rent-A-Center segment from a sales basis performed in these three different eras that we've already been through this year?

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

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Sure. That's all in the year. Yeah. Well, the last couple of years have been a good turnaround for Rent-A-Center and the company had struggled a few years ago. The team has done a good job getting the company back on track in the last few years. And we started out this year very positively and we're well ahead of our plans when the pandemic hit even though only a couple of months have gone by in the year. So, then it hit. And again, we weren't totally shutdown. We didn't know exactly what's going to happen, but we were never totally shut down in the Rent-A-Center side in this segment that we're talking about. So, we kept business going. It was slow the first couple of weeks as people trying to figure out what the heck was going on.

But e-commerce business started to pick up virtually immediately and we have the recurring revenue of the portfolio and the portfolio started building with the e-comm orders. Even with people staying at home and then people started to get out a little more depending on the state of course and between the e-comm growth, which in April, as we said in our call in early May, was over 100% growth. May was close to that. We're talking about double the e-comm business. And e-comm business was about 16%, 17% of our business in the first quarter. I think closer to 17%.

We said then it's heading towards 25%. What we've – I mean we're well on our way to 25% by the end of the year. In the e-comm business, isn't just our customer sitting at home using our – ordering online instead of coming in the store. Before the pandemic, it was growing in the 25% range and had already grown to 17% of our business, growing about 25% quarter – year-over-year.

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And about two-thirds of those customers that are coming in the e-comm are new customers to Rent-A-Center and so it doubles in April, and two-thirds are still new. So the new customer growth is doubling on the e-comm. So, it's not just our customers sitting at home using websites, coming on store. So, tremendous growth, never hit an e-comm site, never had to shut down the stores. Collections doesn't become a huge problem because it's the least amount of sale and the stores were doing well before the pandemic. A little bit of a slowdown when it first started but the e-comm took off right away for us.

And now with the e-comm and people shopping, and then again, we have to follow the rules. Our rules are everybody has a mask, social distancing, sanitation centers in all the stores and those kind of things and doing our part to try to keep this from spreading, and obviously, certain states have bigger problems than others. So, we're – but the business trends and the Rent-A-Center side have been really strong.

Kyle Joseph
Analyst, Jefferies LLC

Got it. That's very helpful. And can you discuss sales trends, specifically any mix shifts you saw in, call it, the mid-March to mid-April timeframe, and has there been any recovery in terms of discretionary demand?

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

Yeah. Good question. Initially, I think I said earlier, we were able to keep our stores open as an essential business because we're appliances and computers and people working from home and so forth. And if you think about the socio-economic category we do business in, lower middle income, cash credit constraint customer, if you don't have the lease-to-own store open, the rent-to-own store or Rent-A-Center open and a refrigerator goes down during a pandemic, then – or they can't go to the laundromat [indiscernible] (00:11:07) don't want to go to laundromat, how can you not have available wash rack because it's not like Amazon is going to deliver them [indiscernible] (00:11:12) a lease program. So, we were able to stay open.

But, those first – that first month or so to your point, those were the products we were running. I mean, appliances and computers were running and furniture really slowed down and electronics even slowed down except for game consoles. We saw parents running PS4s and Xbox for their kids, as their kids were home because they can't go to school, better get them a game console, right? But a lot of laptops for home schooling and home working and so forth.

And then after about a month, we've seen the shift go back to normal and now people are staying home more, money is coming out of categories like entertainment and travel. And we're seeing people replace their furniture, their old – 10-year old furniture, living room, bedroom mattresses, you name it [indiscernible] (00:12:04).

So, now, it's more back to a normal mix for us where furniture is our number one category again and that which is good for us. It's our highest margin category.

Kyle Joseph
Analyst, Jefferies LLC

Got it. You did a great job covering the e-commerce growth. But you know my background. I cover financials, so what I'm focused on is how have you seen the credit performance impacted by the e-commerce growth both in terms of returns and/or skipped installments?

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

A

The same thing that anybody would talk about an e-comm. Whenever you get good growth in e-comm, you've got a little more fraud on the Internet, right? I guess it's easier for people to lie or try to get through something on the Internet than it would be face to face. So there's a little more fraud there. So we have a little bit more of a loss issue with an e-comm. However, when you look at the whole group of customers, because it's also a customer the ones that don't – that aren't creating a fraudulent account or the ones that – and a few slip through our decisioning and we have a few higher losses there.

But the ones that – the bulk of the customers that are solid good customers make – more than make up for that. So it's a more profitable category for us than walk in traffic all in all. So you have a few more losses. But then the keep rates are much higher and all the rest, the vast majority. 98% keep them longer, 2% more losses. We end up better off and not to mention that it just adds growth. And as a – even if you have 1% or 2% higher losses in that one bucket, the overall EBITDA margin goes up because we're writing growth into a – not a – I don't want to call our stores anymore a fixed-cost model. We have a lot of fixed cost and obviously getting a lot of leverage [indiscernible] (00:13:57).

Kyle Joseph
Analyst, Jefferies LLC

Q

Got it. And so on the topic of credit and the health of the underlying consumer, we've written about this. We're calling it a bit of an upside-down recession at least in the near term. So, can you describe the health of your consumer, also walk through kind of call it the use of proceeds, those stimulus? Are folks paying down their leases ahead? Are they putting on new leases? And then it's uncertain with the stimulus set to end next month, it could be extended, but kind of your longer term outlook for credit performance and the health of the underlying consumer.

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

A

Because it's a lease and not a sale, those are – some of those other things have a lot less impact on us than it would be if we were a finance company, so – because customers can return at any time. So, you don't have that loss problem. They get extra money. Some people pay off their agreement which is good from a cash standpoint. It does cut off the recurring revenue stream. But we do about 70% repeat business, so that extra money to customers, we do more rentals. A lot of customers will pay out one agreement and then rent something else they need because they've got the extra money or it brings in new customers to rent.

So, even though you can get some more payouts which cuts off the recurring revenue, just like what happened in February with income tax returns, overall, it's good for our business because a payout is not a bad [indiscernible] (00:15:31) happy, we're happy, and they rent something else most of the time. So, the money is good, the money helps. It doesn't cut off. It's not like a loan business where there's – when more money is on the street, people don't need loans. When more money is on the street, they rent more. So that's good for us.

We don't necessarily – now. Okay. So that when we don't have that, somewhere down the road when we don't have that, how is the business going to perform. Well, we believe we'll perform just fine. And then we are already are performing just fine and the stimulus pretty much dried up already anyhow, because the credit tightens up above us and people end up getting pushed into a lease-to-own option, not – for a couple of reason. One, they want flexibility rather than a financed contract. Number two, the finance companies tighten up. And so, we get a

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lot of positive things coming our way during this kind of environment where lenders tighten up. We don't have to have another stimulus to keep our good run rate.

Kyle Joseph
Analyst, Jefferies LLC

Q

Got it. That's very helpful. And you actually answered one of the questions from the audience that just came in. And I think that's a good segue to my last question on the Rent-A-Center segment, like in terms of competition, how I think about it is both the availability of credit, which you just addressed, as well as other brick-and-mortar LTO providers. So, can you give us a sense for kind of the two types of competition you face and what changes you've seen in the last few months?

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

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Well, I think the tightening of credit above us for a consumer lender [indiscernible] (00:17:12) prime lenders and subprime lenders is a good thing for anybody in our industry. We feel like we've got the best value proposition in lease-to-own, so that we could take advantage of them more than anyone else. We've – and the brick-and-mortar stores, we stayed open in the stores where we could. We didn't close our showrooms. We did close about 25% of our showrooms where the order made us close it.

We didn't close any stores. We just closed the showrooms where we had to do curbside only. We only did that where we had to, like 25% of the time. And others in our industry close – went full showroom for six, eight weeks. We only did it when we had to. So I think we had an advantage. And we've built – we're able to build our portfolio better than our competition by doing that and it worked out. We stayed safe. Our safety numbers are great as far as any internal issues with the pandemic. So, I think it worked out well for us.

And I think the biggest point there is the tightening credit helps us in the Rent-A-Center side by people going in the lease-to-own contract. And again, the flexibility of the lease-to-own contract is something people want as well rather than commit to a financing transaction because of the uncertainty. So uncertainty helps us.

And then on the – we'll get to the retail partner side. With the retail partner side, we see it more directly, Kyle, because in the store, it'll have all three transactions going on at the same time; prime lending, subprime lending and [indiscernible] (00:18:45) that business as well.

Kyle Joseph
Analyst, Jefferies LLC

Q

Got it. I think that's a good segue to jump into Preferred Lease. And you guys acquired Merchants Preferred last year, really integrated in the fourth quarter if I'm not mistaken. But can you just talk about the integration? Obviously, it's a unique environment in which to be integrating businesses. But at the same time, I think a relatively attractive environment for the combination of the two businesses. So just talk about the integration as well as the opportunity for the combined company.

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

A

Yeah. It's gone really well, really, really well. And we had a staffed model called Acceptance Now and we staffed our stores. And that's the only way we do business because we only do business with higher volume retailers like Bob's Discount Furniture or Ashley or Rooms To Go, some of the larger ones that had the volume where [indiscernible] (00:19:45) store and they close a lot more transactions than the sales people of the retail world. But

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then you start to run out of people [indiscernible] (00:19:52) buying and you start getting into change where there's only going to be a transaction or two a day and then you can't afford the labor, yet there's a lot of business to be done.

So we decided after we have recovered as a company, after over the last couple of years that we needed to – our growth [indiscernible] (00:20:07) going to be virtual and not just the staff because we're running out of volume heavy dealers, so we could put the staff in. So, we ended up speeding things up by buying a small competitor Merchants Preferred last August. They had the technology platform, the contact center, the sales team that we needed to grow the virtual business.

The integration is completed. It's gone very well and now we have a virtual business that's almost 3,000 locations and roughly the thousand still on the staff. And that's our growth vehicle. There's a lot of growth opportunity in that segment, mostly in the virtual side but we still – the differentiator between us and our competition is we can still tell retailers if they've got a few stores that make sense with [ph] staff, then (00:20:54) we'll do it.

So we're differentiated from other virtual players and there's a few others. We're differentiated because we'll staff [indiscernible] (00:21:00) virtual, whatever makes sense for us and the retailer. And the other differentiator for us compared to the other virtual guys is you don't have to have a bank account for it to get approved with us or do the business with us. So, we do business [ph] without (00:21:13) bank. So we do business with more people, more customers than any of our competition does. So that's our – those are our differentiators.

As we go out in the marketplace, now that we've made the acquisition, integrated last year, as we hit this year, with tremendous growth opportunity, those are our two differentiators and a little bit of a slowdown with the pandemic as far as new retailers, but as credit tightens above us, retailers are more interested in adding our [ph] product home (00:21:45). And we hired a national sales guy at the end of January, Paul Hamilton, from TD Bank, did national accounts for them. And he's been talking to people all through the pandemic, working on national accounts. The sales team is up and running – back up and running as close to 30 people all in. We've added leadership into that organization – the Preferred Lease organization adding a gentleman by the name of Jason Hogg just this week, tremendous fintech background.

So, to answer your question, Kyle, the growth opportunity is there [ph] in a $25 billion (00:22:18) plus industry retail partner potential, at least $25 million. We feel very optimistic about our future. It's about an $800 million segment now. You've heard us say that by 2022 just adding the regional players that we're adding on a consistent basis now, we think that'll be $1.2 billion with improving margins as we scale. And then national – we have national accounts on top of that. It gets even bigger. And quite honestly that what we're seeing now, we're not going to talk about [ph] names or (00:22:50) anything like that, but quite honestly, I'd be really surprised if we didn't have a national account or two signed up by the end of the year.

Kyle Joseph
Analyst, Jefferies LLC

Q

Got it. And then in terms – you talked about a lot of the retail partners or furniture. Can you give us a sense for how invoice volumes – we saw your numbers in the first quarter and they were strong but I think that was supported by strong January and February. But – and as we got into the pandemic in the mid-March to mid-April when it was – when the economy was essentially shut down and kind of again voice volume trends since mid-April as things have started to open back up.

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

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I mean the demand has been fantastic as those furniture stores reopened. And the portfolios are coming back really quickly. We had the recurring revenue even when a lot of them were shutdown but – and some of them weren't closed that long depending on the state as you know. And we're able to keep that portfolio rolling and they're coming in with strong demand. We won't – the numbers we have forecasted for this year we didn't hit in April, I suppose during April or May. But we're certainly on track to be back on those numbers now going forward.

Kyle Joseph
Analyst, Jefferies LLC

Q

Got it.

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

A

If not higher going forward actually.

Kyle Joseph
Analyst, Jefferies LLC

Q

And then we've got time for two more quick questions. Can you talk – give a high level on credit performance at the Preferred Lease segment, and how that's been trending and any differences you're seeing there between that and the Rent-A-Center segment?

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

A

Yeah. We've talked about there being some pressure on losses, particularly in the Preferred Lease business because of the shutdown. But we don't believe that there'll be significant increases in losses in that segment. As you know, because we're a lease-to-own operator, the customer can return the product at any time. And so that's always an option. And the one thing to keep in mind with our loss rates is that we don't continue depreciating the product as customers are past due or stop payments. And so, we will see some pressure on losses from the shutdown and because of the way that we – our depreciation works.

But if you focus on EBITDA margin with the guide that we gave on the second quarter, we expect that our EBITDA impact year-over-year to be less than 10%. And as Mitch said, we're outperforming our original expectations that we said at the beginning of the pandemic. So, we feel good about the loss rates that even though there'll be some pressure that our EBITDA margins will continue to – the focus on the EBITDA margins will continue to perform well.

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

A

Yeah. And some of that, Kyle, as we get compared to our competition sometimes on the losses and our numbers are higher, but to Maureen's point, it depends whether you depreciate the product all the way down, well it's going past due versus holding the costs. And then you have to take the whole costs, and so, where do you put the number, growth, profit or losses, that's why Maureen is talking about just look at the EBITDA margins and how is it growing and a little bit of loss pressure. But not much [indiscernible] (00:26:14) customer still has the opportunity to return it, still not a finance contract.

So, it's not like it blows up or anything from a loss standpoint. It's – the business model is very resilient. Both on the Rent-A-Center side as well as the Preferred Lease side for the same reasons.

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Kyle Joseph

Analyst, Jefferies LLC

Got it. And then one last one, which came from the audience, so don't get mad at me. But, in terms of looking at towards November, any thoughts on regulatory concerns?

Mitchell E. Fadel

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

No, I don't – November, I presume we're talking about the election. You know that the – we've got 47 states plus the District of Columbia and Puerto Rico that have lease-to-own loss that we follow. There's not been federal legislation. The CFPB was formed obviously before the current administration charter, primarily written by Elizabeth Warren, and what's in that is leases that are three months or longer. Because to try to regulate leases that are terminable at any time by the customer is kind of like putting finance regulation around [indiscernible] (00:27:23) and they can return it anytime.

And we disclose properly under the state laws, as far as what they'll pay if they do keep it throughout, what their ownership options are and all those kind of things. So, no, it doesn't – no matter who wins the election in November, it doesn't give us any cause.

Kyle Joseph

Analyst, Jefferies LLC

Got it. I think we're out of time or a little over time. Apologies for that. But thank you, Mitch and Maureen. Thank you to everyone that dialed in or logged on. Really appreciate your time. And thanks very much for attending.

Mitchell E. Fadel

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

Thanks, Kyle. Thanks for doing this.

Maureen B. Short

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

Thank you.

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