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Rent-A-Center, Inc. (RCII)

Q4 2016 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and thank you for holding. Welcome to Rent-A-Center's Fourth Quarter Earnings Release Conference Call. At this time, all participants are in a listen-only mode. Following today's presentation, we will conduct a question-and-answer session. [Operator Instructions] As a reminder, this conference is being recorded, Tuesday, February 14, 2017.

Your speakers today are Mr. Mark Speese, Interim Chief Executive Officer and Chairman of the board of Rent-A-Center; Maureen Short, Interim Chief Financial Officer and Daniel O'Rourke VP of Finance.

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

Daniel O'Rourke
Vice President - Financial Planning & Analysis, Rent-A-Center, Inc.

Thank you, Shannon. 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 fourth quarter of 2016. All related materials 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 conference call over to Mark. Mark?

Mark E. Speese

Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

Thank you, Daniel. Good morning. Welcome and thank you for joining us. Today, we'll discuss in greater detail our fourth quarter results, share more about what we have assessed over the last several weeks or months; and more importantly, where we believe our opportunities lie and the actions that we are and we'll be taking to improve operations and drive greater shareholder value.

As we mentioned in the pre-announcement call last month, the fourth quarter proved to be much more challenging in our Core stores than we anticipated. To put it plainly, we are not satisfied with these results.

As we outlined, the POS system outages during the third quarter, the heavy promotional activity, and the quarter's historically high delinquencies, as well as other challenges impacted the results. On a more positive note, however, we're encouraged that we have not experienced performance issues with the POS system in more than three months. Now that said, we have been taking a hard look at the business and recognize that urgent action is necessary to improve our performance and the results.

With that, I'd like to first address where we believe we went wrong and what we are doing to fix it. First, and to be frank, many decisions over the recent past were driven primarily by a drive to manage costs. What made Rent-A-Center an industry leader was delivering high quality products and services, a best-in-class customer experience at a fair price and hiring and retaining great talent. We lost our focus in these key areas and execution at the store levels suffered as a result.

Today, we're focused on resetting the business by returning to these differentiators to meaningfully improve our Core business. We will accomplish this by improving our product mix, delivering a better value proposition, stabilizing our workforce and improving our account management.

I would like to spend a few minutes detailing how we intend to achieve each of these objectives. Regarding our inventory management or product mix, over the past year or so, the company gradually shifted away from offering higher-end aspirational products to renting more, less expensive or promotional products. This caused our mix of products on rent and our in-store inventories to shift towards lower priced merchandise. Now while we have always offered a selection of good, better and best products, historically, we know that many of our customers want and will select the aspirational better or best products in a category. This provides more value to the customer and drives a higher ticket for us.

However, in our current inventory, there simply is not enough of the better and best product offerings. As we work through our inventory in the near-term, we will remain focused on achieving the optimal mix, which historically had better and best products at approximately 60% of our mix; while today, better and best comprise only 45%. To provide you with some sense of the impact our shift to these lower priced products has had, our average monthly rate is down about 8% from just a few years ago. We believe reversing this trend in our inventory will deliver a better customer experience, better results for the company and drive value for our shareholders.

On the value proposition, over the past couple of years, we have moved away from our traditional two-by-two pricing formula and introduced more variability into how and at what level we price our products, while some of these changes made sense, the details show that there are pricing opportunities that would provide a more compelling value proposition for our customers and at the same time enable us to recoup our product investment sooner in the life cycle.

For example, today, products are in our system, our rented more often yet they are on rent less time on average and generate less rental income over their useful life. The ROI on our product investment is down almost 10% over the last two years, where we had collected an average of three times our inventory costs over the life of the product historically, it has slipped to 2.7 times today.

By providing a better value to our customers, we intend to turn over the inventory faster. At the same time, extend the average time on rent. The shorter inventory cycles and improved agreement retention will improve cash flow and increase the ROI on our product investment. And overall, as you'll hear me say throughout my comments today, we need to and will be more customer-centric in our offerings.

Regarding people, we must also stabilize our store level workforce. As you may know, we implemented a new flexible labor model intended to pull over time out of the Core business by adding part-time co-workers. Under the original flexible labor plan, one full-time co-worker position was eliminated in exchange for three part-time employees and the remaining full-time co-worker labor hours were reduced. While this did reduce our labor costs, it also substantially increased turnover and negatively impacted our customer service.

Our business has always been built on strong relationships our co-workers have with our customers. The increased turnover and lack of time and continuity to attain the necessary proficiency in the job negatively impacted our sales, our collection skills and our overall customer experience and relationships. In short, we believe the fewer consistent interactions between customers and tenured, experienced and highly trained co-workers adversely impacted sales and caused higher delinquencies.

To address these challenges, beginning in September, we began adding back a full-time co-worker to most stores while reducing, but not eliminating, our use of the part-time co-workers. These changes will add some labor costs back to the stores, but those costs will remain lower than they were before we introduced the original flexible labor model two years ago.

In any event, we believe that investing in our frontline co-workers can only improve customer satisfaction and business results. In fact, we've already begun seeing a positive impact on our store level turnover already. The quality of the portfolio itself. As we previously shared, delinquencies were at record highs throughout 2016. More delinquencies means more time allocated to collections and less time to sales activity, which in turn hurts our deliveries.

By consistently executing our proven collection processes and improving our co-worker training, including more thorough verification and approval processes, as well as accountability, we will reduce the percentage of customers that are past due and collect more of our potential revenue. But doing better collections alone isn't enough and an immediate and significant opportunity I see is to improve the quality of our portfolio.

Providing higher quality products and an improved value proposition for customers, for more tenured co-workers will improve collections. We have already begun seeing improvements in our delinquencies over the last 30 days as well and that should gradually translate to improved collection results as well as revenue.

Now as you've heard, many of these changes have already been put in place or will be over the next 30 days to 60 days. We are moving forward with urgency, but also recognize that the rent-to-own portfolio is a portfolio business, the nature of what we do, and that it takes time to turn over the agreements currently on rent and the inventory that is currently in the system before we'll see the improvements in the bottom line financial results. And while we see progress being made to do it, it takes time and we intend to do it right.

Now in addition to these near-term operational initiatives, we're committed to taking aggressive actions over the longer-term and are evaluating the number of cost saving and revenue driving opportunities to further enhance shareholder value and drive our turnaround. As an initial action, yesterday, we announced and executed a head count reduction that impacted approximately 6% of our field support center workforce.

Importantly, these reductions will enable us to make the corresponding investment in full-time store co-workers, which we expect will improve the business results, as I just outlined. We're focused on evaluating additional opportunities as well to make Rent-A-Center a stronger and more profitable organization. And we look forward to sharing more of those details about the plans in the future.

Let me now just spend a few minutes detailing the results of our Acceptance Now business. A Now posted top-line results during the fourth quarter that were generally in line with our expectations, although, our account management results were disappointing. Similar to the Core, A Now delinquencies were higher than expected for much of 2016 and that translated into elevated losses in the fourth quarter.

The A Now operations team are focusing their efforts on executing proper collection practices. In addition, we continue to implement decision engine enhancements, driven by our data analytics competency that will help reduce the skip/stolen losses as well as potentially increase revenues. And like the Core, there are certainly some opportunities to improve the customer experience through enhanced pricing and terming, which we believe will also lead to more profitable growth.

Now looking ahead to 2017 and beyond, the Acceptance Now team has developed a strong pipeline of future growth opportunities that we are very excited about. In fact, I'm pleased to announce that for the first time, we have signed test agreements with two separate retailers with national store footprints. Both of these pilots should begin sometime in March and run for approximately six months and include approximately a dozen locations in the one case and approximately two dozen locations in the other. We look forward to sharing more about these exciting agreements as time progresses.

Let me spend a few minutes on our digital strategy. This is an important element of our transformation, because it enhances the way our customers engage with us and accelerates growth across all of our channels. And you'll hear more about our digital capability expansion in the coming months. But, today, I'd like to share some ongoing actions in this space.

Based on the early success of the e-commerce operational pilot and rollout in 2016, we are expanding the number of products we offer to our online customers. And we're pleased to report that approximately 60% to 70% of our e-commerce customers are new Rent-A-Center customers and we believe that digital channels such as this one will be key to expanding the customer base for the rent-to-own industry as a whole.

We've recently enabled new electronic payment solutions that increased the predictability and consistency of payments from our customers and we will launch an additional payment innovation in the coming months that we believe will lead to higher ownership levels. And of course, our customer decision models and the underlying technology continue to evolve, allowing us to enhance access to the RTO services across multiple channels.

Our goal for the technology investments we made is to accelerate competitive advantage for the company, while delivering a differentiating experience for our customers. We'll continue to develop our digital capabilities and you'll see a richer digital engagement from Rent-A-Center in the next three months to six months. I look forward to discussing the positive impact to our customers and our shareholders in our future conversations throughout this year.

Some other opportunities. Like just about every retailer today with the brick-and-mortar business channel, we are and will continue to evaluate the strategic value and role of our Core store base in our evolving customer marketplace. And while, we all have an ongoing need to rationalize the store base in over-penetrated markets, the regular hygiene, so to speak, we also recognize the value that many of our customers place on having Rent-A-Centers in convenient, easily accessible locations in their neighborhood.

Given the challenges that we faced this past year in the Core, there is clearly room for operational improvements that we believe, can and should, diminish the number and scope of potential store closures. At the same time, we plan to evaluate the possible expansion of our franchise network, of which there's a fair amount of interest as well.

Looking to the south, I'm happy to report that our results in Mexico improved significantly last year. In fact, our Mexico operation is now generating positive EBITDA and positive free cash flow. Our in-country manager, Federico Fidalgo and his team have made great progress in the 18 months he has been in position. We're pleased with the growth and direction that we've seen recently. We believe there is opportunity in Mexico and we are evaluating the best path forward.

As I mentioned on our call last month, the board has started its process to find a highly qualified permanent CEO and CFO that have all the required skills and are the right cultural fit. The key will be finding the best match with the company and its strategies in order to fix the business and position us for long-term success. While we will not provide interim updates on the search until the progress is complete, what I can say is that the search will be thorough and that the board is committed to hiring the best suited candidates. In the meantime, my focus remains on improving the business in driving Rent-A-Center's turnaround.

And as we execute on the turnaround of the business, we will provide an increased level of transparency on key leading indicators to measure our progress. As noted in the release last night, these measures will replace the revenue or EPS guidance for 2017. On a monthly basis, we plan to update you on the following critical business drivers.

For our Core stores, we will provide same-store sales, the average weekly percentage of customers that are seven plus days past due versus the prior periods, co-worker turnover versus the prior-year, and the average monthly delivery rate per agreement versus the prior-year.

For Acceptance Now, we'll provide same-store sales and the average weekly percentage of customers that are 32-plus days past due versus prior periods. As a reminder, the Acceptance Now is a monthly pay business and the Core is primarily a weekly pay business.

And through these monthly updates, we hope to improve transparency and build confidence in the business. Although we expect that it will take a couple of quarters before the actions we're taking begin to appear in the financial returns.

I started this company with a simple belief that we can make our customers' lives better by providing them with great products and services and much needed financial flexibility. As I've said before, I truly believe in this company, its coworkers and its future prospects. I'm passionate about what we do as an industry and our important role of serving the credit-challenged and cash-constrained consumers.

As one of the company's founders, the former CEO and a large shareholder with a strong vested interest in growing shareholder value. I'm highly committed to improving our performance and driving long-term success.

We are in a tough patch but our business is sound. And I'm confident that the actions we're taking will drive both near-term and long-term improved results in the Core and Acceptance Now and enhance shareholder value. I do want to acknowledge and thank our 20,000 co-workers for their dedication and efforts, particularly over these past 30 days.

With that, I'll now have Maureen provide you with more detail results on the fourth quarter. Maureen?

Maureen B. Short

Interim Chief Financial Officer, Rent-A-Center, Inc.

Thanks, Mark. Good morning, everyone. As I walk you through the financial results for the fourth quarter, all numbers will be presented on a recurring basis, excluding special items for both this year and last year.

As outlined in the press release, consolidated total revenues were $684.1 million, which represents a 13.8% decrease versus last year, driven by the Core same-store sales decline of 14.2%. Within our Core U.S. segment, total revenues were down 17.6%, driven by the same-store sales decline of 14.2% and an 8% reduction in store count from the prior-year. The same-store sales decline is primarily due to the recovery challenges from the POS system outages that took place in the previous quarter, heavy promotional activity and historically high delinquency.

In the Acceptance Now segment, we saw a 1.7% revenue decline due to lower store count, which was partially offset by higher same-store sales, which were up 1%. Consolidated gross profit was $442.7 million and gross profit margin was 64.7%, 160 basis points lower than a year ago, primarily driven by higher Core promotional activity. In the Core U.S. segment, gross profit margin was 69.7%, 140 basis points lower than a year ago, driven by heavy promotional activity.

In our Acceptance Now segment, fourth quarter gross margin was 53.2% down 50 basis points from last year, this decrease was driven primarily due to lower gross profit margin on merchandise sales. Consolidated store labor, which includes the expenses associated with co-workers at our stores and at the district manager level increased 160 basis points to 28.5%. Other store expenses which include expenses related to occupancy, losses, advertising, delivery costs and utilities increased 250 basis points to 28.3%.

In our Core U.S. segment, store labor expense was down approximately $17.3 million versus the prior-year, but worsened by 250 basis points due to sales deleverage. Other store expenses were also down $16.1 million, but worsened 260 basis points due to sales deleverage and higher skip/stolen losses. Our Core skip/stolen losses were 3.7% in the quarter compared to 2.6% last year, given the collections issues associated with the new POS system, sequentially charge-offs improved 100 basis points.

In our Acceptance Now segment, labor as a percentage of revenue was flat to last year. Other store expenses increased 350 basis points, driven by higher skip/stolen losses, which were 12.5% up from 10.5% last year. As Mark mentioned, there are a number of opportunities we are working on that we believe will improve skip/stolen losses going forward in those segments. On a consolidated basis, our operating margin was negative 1.4%, representing a decline of 820 basis points and consolidated EBITDA was at 1.5% or down 780 basis points from a year ago.

Now turning to the balance sheet we ended the quarter with consolidated inventory on rent down approximately 12.4% or $113 million versus a year ago. This decline was primarily due to a drop in inventory on rent in the Core U.S. segment, which was down 20.9% or $113 million. The key drivers were lower same-store sales, an 8% reduction in store count and lower product cost from the benefit of our sourcing initiative.

In the Acceptance Now segment, inventory on rent increased $4.4 million or 1.3% due to higher purchase volumes in our retail partner locations. Consolidated inventory held for rent was down approximately $22 million or at 9.6%. This was driven by the Core U.S. segment, which was down $23 million or 10.5% due to lower store count actions taken to move through older inventory and more lower cost promotional products.

At the end of the fourth quarter, we have approximately $95 million in cash and cash equivalents. We were undrawn on the revolver and we have reduced our total debt by approximately $234 million this year. Our leverage ratio for the quarter was 3.58 times and the fixed charge ratio was 1.50 times, both meeting our covenants. In addition, we have been proactively working with our lead bank to evaluate options to address our capital structure needs for the long-term and believe we will have flexibility to pursue our strategies.

Lastly, I'd like to touch on the goodwill impairment that was taken in the quarter. As a result of the decline in our stock price that occurred following the earnings pre-release on January 18, the completion of our annual testing process was extended. Ultimately, the process resulted in the recognition of $151.3 million impairment of our goodwill in the fourth quarter, thus writing off all of the remaining goodwill in the Core U.S. segment.

The impairment is a non-cash charge and does not affect liquidity, debt covenants or the company's ability to declare and pay dividends. Because of the delay in completing the impairment analysis, we are still in the process of finalizing the income tax effect of this impairment charge and certain deferred tax items and expect to include this information in our 10-K. As a result, we are unable to report diluted loss per share for the fourth quarter of 2016 on a GAAP basis at this time.

With that, I will turn the call back over to Mark to make one more comment before opening up the line for questions.

Mark E. Speese

Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

Thank you, Maureen. Before we open the line for questions, I want to briefly address the recent filing by Engaged Capital. Our board and leadership team value the views of all of our shareholders and welcome constructive input towards our goal of improving results and driving shareholder value. We have met with and spoken to Engaged Capital several times and hope to maintain a constructive dialog as we work towards the objectives that we've outlined here today. That's all I'm prepared to say on the matter. I would remind you that the purpose of today's call is to discuss the earnings results and the initiatives that we've mentioned. I would ask that you please keep your questions focused on those topics.

With that, Shannon, if you would please open the line for questions, we would appreciate it.

QUESTION AND ANSWER SECTION

Operator: Certainly. [Operator Instructions] Your first question comes from the line of Budd Bugatch from Raymond James. Your line is open. Please go ahead.

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.

Q

Thank you very much. Good morning, Mark. Good morning, Maureen. First, I want to commend you for the decision to put out the monthly metrics. I think that's the right thing to do. I wish more retailers would do it. I hope that's a long-standing regime.

My questions, I guess, go to inventory, because I think that's a metric that we can see and maybe see some improvement in sequentially as we go forward. Can you talk a little bit first of all about in the Core inventory, what's now in Acceptance Now inventory inside the Core? Can you give us a feel of how that inventory is trending?

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

I don't have the exact numbers, Budd, in terms of the number of pieces or the mix of inventory, if you will. It is an opportunity. As I've said during the pre-announce and I think I've repeated again this morning, we know we have excess inventory. We don't like the mix of the inventory. Again, that's really more of the Core inventory being more of the good and less of the better and best.

The distribution that's coming from Acceptance Now is a couple basis points higher than it had been or I think that we might have liked in the past. So, again, I view that as an opportunity. As I said, I think there's some chance to improve. When you look at their delinquencies, the offset of that is there is more returns. And so it's not an unmanageable number by any stretch, but it is an opportunity that we need to focus on.

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.

Q

Okay. Since the end of the year, can you give us any feel of how inventories have trended for rent or own rent?

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

I'd say, generally in line with our expectation, January, historically, you know the first quarter has proven to be challenging for the company. What's interesting and it makes it a little hard to evaluate at this point is the delay in the income tax refunds, right?

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.

Q

Yeah.

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

Normally those would have already begun to hit, and in fact all indications are now it's going to be the latter part of February. So, it's really hard to predict at this stage what that means for the business. You may have some false positives, I would probably leave it at that.

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.

Q

Okay. And the reduction of 6% of the field, can you give us an idea of how many people that is and what the savings might be or when does that go into effect?

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

Well, that 6% again was not in the field, that was here at the field support center or the corporate office, if you will, 6% of the workforce here, and that all took place yesterday.

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.

Q

And how many people Mark, any way to put numbers to it in terms of dollars?

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

Well, from a head count standpoint, it's approximately 70 people. And then again, as I said, we look at those dollars are really being reallocated back into the field, facing the customer, if you will.

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.

Q

I see. We should see probably a severance charge next quarter or something like that, is that true, will that be a one-time on that that we'll have to account for?

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

Yeah.

Maureen B. Short
Interim Chief Financial Officer, Rent-A-Center, Inc.

A

Yes. There will be severance expenses that hit next quarter related to that. We had severance that hit this quarter for executive departures, but the action that took place yesterday will hit in the first quarter.

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.

Q

Okay. And last question for me, is in Acceptance Now, I thought we were testing some centralized collection effort to reduce some of those delinquencies for that and take some of the burden off of the in-store people, is that still going on in and is that having any impact?

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

It's being stood up; they candidly are very early into the process. Our expectation is, is that, it will have a positive impact, but so early into it and it's a small test at this particular point. Directionally, I think it's going to be good, we don't have enough there yet to give you any specifics on it.

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.

Q

All right. Thank you very much and good luck on the turnaround.

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

Thank you.

Operator: Your next question comes from the line of Brad Thomas from KeyBanc. Your line is open. Please go ahead.

Bradley B. Thomas
Analyst, KeyBanc Capital Markets, Inc.

Q

Yes. Thank you, Mark and Maureen for taking my question. I guess, first a question on the initiative around the good, better, best, mix, Mark. The company's mix from a product category perspective has changed a lot over the last 10 years, how much has that been a factor and which categories if any maybe stand out as having the best opportunity to increase their mix of better and best?

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

Well, there's opportunities across the continuum. I think from what I've seen at this point, furniture, I would put at the higher end in terms of opportunity, but I wouldn't limit it there. Some of the product inflation has had a little bit of an impact when you look at the electronics, but at the same time there is still opportunities within that SKU. I would say, furniture probably has the biggest category opportunity across the mix.

Bradley B. Thomas
Analyst, KeyBanc Capital Markets, Inc.

Q

Okay. Great.

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

Another part of your question, did I miss a second?

Bradley B. Thomas
Analyst, KeyBanc Capital Markets, Inc.

Q

No, I was just asking about the categories and if that had any importance as you thought about the good, better, best initiative that you have? I guess, moving on to talk about cost. You talked about how in recent years the company is going to focus on costs, you will reinvest the savings from the head count reduction at the headquarters.

I guess, Mark and Maureen, as you think about the company's cost structure overall moving forward this year, do you need to, on a net basis reinvest or will you still be bringing costs out when we think about labor and other operating expenses?

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

Well, I think, we're continuing to evaluate other cost saving or revenue generating opportunities, as we speak, Brad. I've mentioned a little bit on the store rationalization plan, again, that needs to be worked. I think, there may be some opportunity to bring cost down. We're continuing to do some of that work.

Candidly, I think, the bigger opportunity we have is, some of the revenue driving things that we've spoken off. As we think about the value proposition, the product offerings, the pricing, the life cycle of the inventory that's in the system, the customer-facing staff in the stores, the collection activities, and so forth. There are number of things that I believe we can do that will have a much greater, positive impact on driving the top-line. At the same time, we'll continue to evaluate other cost saving opportunities.

Bradley B. Thomas
Analyst, KeyBanc Capital Markets, Inc.

Q

Great. And then from a modeling standpoint, I know you don't want to provide earnings guidance, but could you share some details with us, Maureen, and where you think maybe CapEx and depreciation and interest expense and such might come in?

Maureen B. Short
Interim Chief Financial Officer, Rent-A-Center, Inc.

A

We are not providing any guidance for 2017, just the monthly progress forward on the turnaround. We want to make sure that we're showing that progress in the near-term, knowing that the financial benefits of the changes that we have already made and will make in the near future is visible and transparent to our investors.

Bradley B. Thomas
Analyst, KeyBanc Capital Markets, Inc.

Q

Got you. And then just lastly, could you give us an update on conversations with your lenders, and any color on how you might be thinking about the dividend that you're paying today, and if that would continue?

Maureen B. Short
Interim Chief Financial Officer, Rent-A-Center, Inc.

A

So, as I mentioned in the prepared remarks, we're proactively working with our lead bank to determine the optimal go-forward capital structure on a longer-term basis, and we'll provide updates, once we know more about what that looks like.

Bradley B. Thomas
Analyst, KeyBanc Capital Markets, Inc.

Q

All right. Thank you and good luck.

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

Thank you.

Maureen B. Short
Interim Chief Financial Officer, Rent-A-Center, Inc.

A

Thanks.

Operator: Your next question comes from the line of Laura Champine from Roe Equity Research. Your line is open. Please go ahead.

Laura Champine
Analyst, Roe Equity Research

Q

Thank you. Just wondering since we are in the middle of February, can you give us some of the metrics that you spelled out for the month of January?

Maureen B. Short
Interim Chief Financial Officer, Rent-A-Center, Inc.

A

Laura, we will be providing an update to our January metrics here in the coming weeks. We have started working on those numbers, but we weren't able to provide that with the release last night.

Laura Champine
Analyst, Roe Equity Research

Q

Okay. So...

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

Yes.

Laura Champine
Analyst, Roe Equity Research

Q

Can you give us a sense of the direction of January same-store sales since those should be in the books at this point?

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

Trending positively, sequentially they're trending positively. Again as Maureen said, unfortunately, we don't have the specific numbers to provide, we will do so in the near future. And I'm pleased with what I've seen on the metrics that have been put out there.

Laura Champine
Analyst, Roe Equity Research

Q

Great. Thank you.

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

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

Q

Thank you. Good morning, Mark and Maureen. I was wondering, could you clarify, when you talk about value proposition, are we net raising prices in Core and Acceptance Now, or is that not the plan?

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

No, John, you may recall, there are a number of different levers that you can pull in this business, so when we talk about pricing, there is the weekly or monthly rental rate, there is the term in which to acquire ownership, the number of weeks or months. And then there is the EPO formula that goes into that to the extent the customer wants to exercise. And you can pull a combination of those levers, one of those levers, and so forth.

Candidly, when I talk about opportunity to enhance the proposition, I think, we can lower the terms which will enhance the value to the customer without increasing the rate, because they allowed those terms to go out quite a ways trying get margin. And it's devalued the proposition and it's had a negative impact on sales.

So, part of it is right-sizing – reevaluating the inventory that's in there and setting the proper rates and terms and then the bigger opportunity is the mix as we go forward. That's where we're going to have a bigger opportunity to enhance the value proposition for the customer.

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

Q

And yeah. Talk to me about mix improvement, again, be as specific as you can be on what that means?

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

Well, as I said in my prepared remarks, looking historically, if you think of good, better, best and that's how we kind of describe our products and that may have to do with the quality of the merchandise, the features and benefits of the merchandise, the material that's in the merchandise, i.e., leather versus vinyl, a refrigerator with an ice-maker versus one without, et cetera, et cetera.

Historically, and again those are the aspirational products, when customers, any of us buy we have needs and wants. The emotional side of a purchase is fulfilling the want, not the need, and I believe that's where our opportunity lies is to put a greater focus on fulfilling the emotional side, the want, which is a higher mix of the better and best.

And, as I said in my prepared remarks, where we had been historically about 60% or so between the better and best, today it's only 45%. So a much greater shift at a lower cost value, if you will, and again that's had the 8% decline on our pricing, the APU. So, it's not about charging more for the same, it's about increasing the value proposition for the customer.

And as you know, we're in a fixed cost business, so to the extent you can drive or increase the rental associated with any agreement, the flow through could be pretty significant to the bottom line because of the fixed cost nature of the business.

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

Q

And Mark, could you talk to us about, where the current Core store mix of used versus new inventory for rent on the store floor is and compare that to history. And then assuming that's lower than you want it or more used than you want, it would imply some level of inventory investment. Is that the plan? And I know cash flow is dear, but just curious, how you're going to walk that tight line?

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

That's a good question, John, and in fact the mix is not materially different than historical i.e., 25% or so new and 75% previously rented. So, it's not so much a new use. It's the mix. And part of the reason they have the new is, because, again, the amount of buys that were made in the fourth quarter, the promotional, if you will. And as we've said, the fourth quarter was not as good as the company had hoped and so there's a plenty of new inventory in the system. I think we can work through it in an ordinary course of business. We've been trying to take advantage of the income tax season when it comes and so how we might be able to move inventory quicker than you would have otherwise, given the time of the year, but this is not a used inventory problem.

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

Q

Okay. And then my last question is just – and I appreciate you not wanting to give 2017 guidance. But as we exit 2017, what would be your broad, high level, two or three either metrics or things you want to see that in your mind are crucial, that would tell investors we've right-sized the business or turned to improving results in 2018? I assume 2017 is going to still be a challenging year. Just curious how you're thinking about that broadly. Thank you.

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

Thank you, John. I'll be honest. The metrics that we picked directionally will tell you everything. So, we are in a relationship business. Having stability and continuity and customer-facing co-workers is critical, hence, the reason that we want to provide the turnover. And so, as we can make improvements and strengthen the workforce, improve the customer relationships, our selling skills and collection skills, that's going to show there.

The delivery APU, this notion of our value proposition and going to more of the better, best from good is why, again, you should see the delivery APU. So, what are the customers wanting to rent today? Are they in fact coming in and getting the aspirational products? And, again, fixed cost nature we drive the revenue per agreement. That's going to show the positive impact to the top-line and then the flow through to the bottom-line.

Collections, again, the quality of the portfolio – it does no good to put a lot of products on rent if you can't then collect on them or manage the accounts when they're out there. And so, the delinquency is an important characteristic and also how much time is being spent on that aspect of the business versus being able to spend additional time on the sales side, right?

And so, any of these that we team up with really they're leading indicators. And given the portfolio nature, you want to see those kinds of trends first, because it's going to draw the picture, the roadmap, of where you're going to end up six months or nine months down the road.

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

Thank you and good luck.

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.
A

Thank you.

Operator: Your next question comes from the line of Anthony Chukumba from BB&T Capital Markets. Your line is open. Please go ahead.

Anthony Chinonye Chukumba
Analyst, BB&T Capital Markets
Q

Thank you for taking my questions. So, I guess, my question was about the higher delinquencies in Acceptance Now. And I understand that the point-of-sale system issues on the Core business was one of the main factors for the increase in the delinquencies and maybe some of your promotional activity. But I guess I was just trying to figure out what drove the higher delinquencies in Acceptance Now, given that I don't believe that those point-of-sale issues in the Core were an issue in Acceptance Now?

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.
A

I think there's a couple of things, as they continue to have – the mix of partners. Meaning, as you get into more multi-line partners rather than a furniture-only, some of the behaviors are a little bit different across the product lines. And so, as we expand into multi-line partners that are introducing the other SKUs, they have historically performed a little less. And so as that mix shifts, you're starting to see some of that in the overall results.

There are opportunities. As I said, I think, some of the – it's fair to say much like the Core, that there's some executional opportunities as we think about across all of the businesses, whether that's collections and sales or so forth. So part of it is a mix of the relationships that we have and the products that we're putting through that pipeline. And then the other part is we need some further enhancements in our risk engine and the training and accountability inside the co-workers.

Anthony Chinonye Chukumba
Analyst, BB&T Capital Markets
Q

Okay. That's helpful. And then just one quick follow-up. You mentioned this test of these two national retailers and I certainly understand that you probably don't want to just go over a lot of information about who these retailers are. But can you give us any color whatsoever even just in terms of what – or sort of what products these retailers carry? For example, are either of them multi-line retailers?

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.
A

I'm not going to get into the specifics. They are narrow test and they'll run for six months and then we'll be in a position to share more as we get further down the road.

Anthony Chinonye Chukumba
Analyst, BB&T Capital Markets

Q

Okay. Fair enough. Thanks for taking the questions. Good luck.

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

Kyle Joseph
Analyst, Jefferies LLC

Q

Hey. Good morning, guys, and thanks for taking my questions. Most of them have been answered, but just wanted to dig down deeper a little bit towards a potential recovery in the Core business. If you could remind us to kind of on the average duration of a rental agreement in recent periods, just to kind of give us a sense of when comps could ease for that segment?

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

I'll make sure I understand the question there, the average length of time that agreement is on rent, is what you're asking?

Kyle Joseph
Analyst, Jefferies LLC

Q

Correct. So, I mean, you missed a lot of sales in the third quarter because of outages, and I'm just trying to get a sense for when we'll lap more challenging comps in that segment?

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

Okay. Yeah. No, the average rental agreement in the Core business is on rent, approximately four months to five months on average.

Kyle Joseph
Analyst, Jefferies LLC

Q

Okay. Got it. That's helpful.

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

The average piece of inventory is in our system approximately 18 months or 19 months on average.

Kyle Joseph
Analyst, Jefferies LLC

Q

Okay. Got it.

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

Okay?

Kyle Joseph
Analyst, Jefferies LLC

Q

And then, just on Mexico, it looked like things deteriorated a little bit sequentially, was that mostly currency-related?

Maureen B. Short
Interim Chief Financial Officer, Rent-A-Center, Inc.

A

Some of that was currency-related, yes, there was also a bit of an uptick in the skip/stolen losses within Mexico. But overall for the year, we were EBITDA positive, which was the goal we outlined at the beginning of the year.

Kyle Joseph
Analyst, Jefferies LLC

Q

Got it. Thanks. And one last one, just more macro-based, given we've had some rate increases, has there been any change to sort of the competitive environment and the amount of credit available to this customer base that you guys have seen at all?

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

No, I don't – again, my lens is narrow, if you will, compared, but Maureen, I don't have – if anything appears maybe be a little bit of a tightening?

Maureen B. Short
Interim Chief Financial Officer, Rent-A-Center, Inc.

A

Yeah. I think just the recent change, I don't know if we've seen any further impact, but it is a challenging competitive environment. We do feel that our customer base has more access to credit than they had historically and that, that is impacting our business. But as far as the recent changes with interest rates, I don't believe we've seen any material changes.

Kyle Joseph
Analyst, Jefferies LLC

Q

Great. Thanks very much for answering my questions.

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

Thank you.

Maureen B. Short
Interim Chief Financial Officer, Rent-A-Center, Inc.

A

Thank you.

Operator: Your final question comes from the line of Carla Casella of JPMorgan. Your line is open. Please go ahead.

Carla M. Casella
Analyst, JPMorgan Securities LLC

Q

Hi, I'm wondering, if you could just clarify, make sure I got this right, the Acceptance Now two test cases. One, you are testing with 12 stores and one you are testing in 24 stores, and what was the timing of the rollouts there?

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

Those are approximate numbers, a dozen and two dozen. We're expecting, anticipating both of those tests starting sometime in March, the agreements have been signed and the test periods are six months in both cases.

Carla M. Casella
Analyst, JPMorgan Securities LLC

Q

Okay. And do you target additional Acceptance Now adds aside from those this year, like in your existing customers?

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

I'm not sure I understand your question.

Carla M. Casella
Analyst, JPMorgan Securities LLC

Q

Oh! Will you or do you think you will see additional new Acceptance Now locations from your existing customers this year?

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

I'm sorry. Yes. I think there are some opportunities to continue to expand the May end of the store locations that we have with our current partners.

Carla M. Casella
Analyst, JPMorgan Securities LLC

Q

Where would you say you're in terms of penetration level with your current partners, are you in 80% of their stores or?

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

Where we want them or where we've agreed, is probably higher than that, I think we're pretty close. But I will tell you, and again, Acceptance Now even beyond these two national tests, they continue to work potential new partners also. So not just what we already have, but there's other smaller regional state partners, if you will, that we're continuing to develop also.

Carla M. Casella
Analyst, JPMorgan Securities LLC

Q

Okay. Great. That's helpful. And then I guess I'm wondering on the consumer side, are you seeing – I mean, with consumers relying more on smartphones and their computers or even watching TVs. Do you think there's just a shift away from renting TVs and other AV?

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

Well, there's certainly been cannibalization within product categories. Advancements in technology, we see it – the computers going from the desktop to the laptop to now the smartphones. And so, there has certainly been some cannibalization across product categories. At the same time, I don't think any of us don't have a TV in our house. So there's still plenty of opportunity.

Carla M. Casella
Analyst, JPMorgan Securities LLC

Q

Okay. And then, where you are in terms of the smartphone, just on what percentage of your product is smartphones?

Maureen B. Short
Interim Chief Financial Officer, Rent-A-Center, Inc.

A

It's about 5% of our revenue.

Carla M. Casella
Analyst, JPMorgan Securities LLC

Q

Okay. Great. And then just one housekeeping, can you give us a sense of where rental merchandise purchases or depreciation for rental merchandise was for the quarter or for the year? Just in terms of calculating or figuring out our cash flow statement?

Maureen B. Short
Interim Chief Financial Officer, Rent-A-Center, Inc.

A

I'll have to follow-up with you later on that, Carla, I don't have that in front of me.

Carla M. Casella
Analyst, JPMorgan Securities LLC

Q

Okay.

Maureen B. Short
Interim Chief Financial Officer, Rent-A-Center, Inc.

A

But it is posted on our website, we have all of the segment financials that were posted last evening that should have that number.

Carla M. Casella
Analyst, JPMorgan Securities LLC

Q

Okay.

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

Yeah. It's there. We just don't have it.

Carla M. Casella
Analyst, JPMorgan Securities LLC

Q

Okay. That's great. That's all I have, thank you.

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

A

Thank you.

Maureen B. Short
Interim Chief Financial Officer, Rent-A-Center, Inc.

A

Thank you.

Operator: We have reached the conclusion of our Q&A session. I would now return the conference to Mr. Mark Speese for closing remarks.

Mark E. Speese
Interim Chief Executive Officer & Chairman, Rent-A-Center, Inc.

Thank you. Ladies and gentlemen, thank you all for your support and your interest this morning. Please note that we are keenly focused and we're taking aggressive actions to improve our operations and results and to drive overall shareholder value. I look forward to reporting on our progress in the coming months as we move forward. Thank you again and have a great day.

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