Corrected Transcript

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Rent-A-Center, Inc. (RCII)

Q3 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and thank you for holding. Welcome to Rent-A-Center's Third Quarter Earnings Conference Call. As a reminder, this conference is being recorded, Thursday, November 7, 2019. Your speakers today are Mr. Mitch Fadel, Chief Executive Officer of Rent-A-Center; Maureen Short, Chief Financial Officer; and Daniel O'Rourke, Senior Vice President of Finance.

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

Daniel O'Rourke
Senior Vice President-Finance, Rent-A-Center, Inc.

Thank you, Jitenia. Good morning, everyone, and thank you for joining us. Our earnings release was distributed after market closed yesterday which outlines our operational and financial results for the third 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.

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Thank you, Daniel, and good morning, everyone. Thank you for joining us. We will be providing a voice over to the presentation shown on the webcast. If you are unable to view the webcast, the presentation can also be found at investor.rentacenter.com.

Overall, we have strong quarter with numbers in line with our internal expectations. And I'll provide an overview of those quarterly results and an update on our strategy, and then turn the call over to Maureen.

Solid fundamentals and execution resulted in another good quarter with progress on both the top and bottom lines. Third quarter consolidated same store sales increased 4.5% and adjusted EBITDA was $56.6 million, an increase of $7 million versus last year. Two-year consolidated same store sales increased 10.2%, which speaks the stabilization of our business. And third quarter adjusted EBITDA was up 14.8% over last year, while EBITDA margins expanded more than 100 basis points. The solid performance is the result of executing our strategy of turning around the business with cost savings and a more compelling value proposition.

So looking forward to the Core US. Driven by the value proposition changes and our e-commerce growth, Core same store sales increased 3.7% in line with our expectations and our two-year same store sales increased 8.9%, which is impressive for any retailer. Overall, revenues were down 3.3% year-over-year largely due to the refranchising and store rationalization. In fact, when you exclude the impact of refranchising, our revenues were 1.1% higher than last year. Our portfolio on a same store basis finished the third quarter approximately 3% higher than last year, a good leading indicator for future same store sales expectations.

Online traffic increased approximately 22% year-over-year continuing the trend we've seen all year. Web orders represented about 14% of [ph] all these store (00:03:34) agreements originated in the quarter which will equate to approximately 17% of our revenue. Over 80% of our web distributed agreements are coming from new customers, giving us confidence in our ability to continue to grow our stores and our e-commerce business and you can see in the chart, the bottom right of slide number 3 (sic) [4] (00:03:53) where its – historical highs for customers per store.

As a result of that positive momentum, adjusted EBITDA improved $8 million or 15.2% above the same period last year. Lastly, on the Core business, [ph] these days we get to ask (00:04:08) a lot about tariff – any tariff impact on our product purchases, and I'm pleased to report based on who and where we get our products from, to date, we have seen virtually no impact from tariffs, [ph] no upgrades (00:04:19) on the tariffs that have been announced do we foresee any future impact from these tariffs.

So, moving on to our AcceptanceNOW business, which does include the results of Merchants Preferred and the segment that we sometimes also referred to as our retail partner business. Our enhancements to the value proposition and the acquisition of Merchants Preferred drove invoice volume of $129 million for the quarter, 19% higher than last year. Same store sales increased 6.2% for the quarter and two-year same store sales increased in the price of 12.8%. Our skip/stolen losses in AcceptanceNOW improved sequentially for the third consecutive quarter to 8.9% of revenues, [ph] 17 (00:05:00) basis points lower than last quarter.

So [ph] internally (00:05:03), the progress of integrating Merchants Preferred has so far exceeded our expectations. As of today, we've integrated the sales team, much of the call center, identified and have started to realize $3 million to $5 million in annualized synergies, [ph] all (00:05:18) investing in additional sales talent to support invoice volume growth. Revenues from Merchants Preferred are on pace to achieve approximately $80 million annually as previously disclosed even with the initial focus on integration. We still managed to open about 200 Merchants Preferred locations since the acquisition which just closed in mid-August.

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Top priorities for the virtual business are going to position our sales team to capture the white space opportunity and show our platform add superior value relative to industry competitors. We will also continue to refine the technology in order to meet the needs of our retail partners whether that would be integrating in our point-of-sale system, launching a mobile app for the hybrid solution. The hybrid solution you heard us talk about it before, when you talk about [ph] Core (00:06:04), we're talking about there is a combination of the staffed and virtual models, which can flex or staff during peak periods and transition our virtual or unstaffed model during the [ph] low sale (00:06:15) volume periods.

The hybrid model is unique to Rent-A-Center and something we view as a key differentiator for us in the industry. We also have a goal of landing additional national retail partnerships. With our unique hybrid offering, we believe we'll be an attractive partner for both large and small retailers. I'm very excited about the virtual and hybrid growth opportunity. I'm confident that we will quickly become even more of a leader in the space.

With the virtual platform becoming a larger part of our business, we're exploring additional metrics to analyze the business and evaluating the best way to illustrate performance. In future quarters, we're focused more on invoice volume and disclose active locations for this business. We will also likely to discontinue reporting same store sales in AcceptanceNOW in the AcceptanceNOW segment next year as that's not a strong of an indicator performance in a virtual e-com world.

So, before moving on our financial highlights and guidance, I want to spend a few minutes to discuss where we're as a company, how we fit within the industry and some enhancements to our strategic plan. As most of you know, over the past two years, we've been able to turn the business around following a period of underperformance. I'm very pleased with what we've accomplished and where the company is today as we're a stronger and a more stable company. We're operationally sound with solid fundamentals, so we understand the large customer base served by the dynamic lease-to-own market.

With over 2,400 brick and mortar locations, Rent-A-Center has the largest physical footprint in the industry. We have a competitive advantage by serving banked and unbanked customers in both our Core stores and AcceptanceNOW businesses. We also have significant growth potential through our virtual and hybrid initiatives as well as e-commerce.

Our advantaged business model generates recurring revenue streams and significant cash flow. We've got proven track record of optimizing costs, and our conservative balance sheet enables us to both invest in growth opportunities and provide shareholders the value through dividends and potential share repurchase. And by investing in Merchants Preferred, we are again transforming our company to meet the needs of today's consumer. We are investing in a virtual platform and we'll provide a hybrid staffing model for our retail partners, which is a key differentiator for Rent-A-Center relative to industry competitors.

Calling attention on slide 7 in our presentation. Over the past 20 years, the lease-to-own industry has grown by approximately 4% on a compounded annual growth rate. There are significant white space in the market through virtual and e-commerce platforms and additional opportunity to expand in a multiple new product verticals. In addition, the industry has demonstrated resilience through macroeconomic cycles, including recessions. And you can see on this slide specifically performance [indiscernible] (00:09:04) did not falter during the Great Recession of 2008 and in fact remained quite stable.

With our conservative balance sheet and strong cash flow, we're making the necessary investments that capitalize on this growth opportunity and become more formidable competitor in the virtual lease-to-own market.

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As I mentioned earlier, the industry is continuously evolving to keep up with today's consumer. Historically, we serve the customer in our brick and mortar stores with on payment – with onsite payment transactions in a personnel employee customer relationship.

As the industry evolves, so did we. AcceptanceNOW was born almost 15 years ago to fill a need at one of our retail partner locations. This increased our customer base and enabled us to meet a new and underserved market. Today, we're a multichannel lease-to-own provider serving the customer with our e-commerce platform at rentacenter.com. And we are once again expanding our presence in the virtual market with the acquisition of Merchants Preferred. Virtual gives us the technology platform to continue serving in over $25 billion market.

And with the turnaround behind us, our strategy going forward, we'll focus on growing our retail partner business within the AcceptanceNOW segment, continuing to strengthen the domestic brick and motor business through advancements in technology, growing e-commerce and maintaining a flexible capital allocation model that will maximize the value for our stockholders.

Our primary focus is on the growth of our retail partner business. [ph] Applying (00:10:31) Merchants Preferred accelerated our virtual strategy in its first few months integrating process – progress has exceeded our internal timeline. We have ample capital to grow the virtual business and by providing our retail partners with the option of a [ph] staffed (00:10:46), a virtual or a mixed model, as I've said earlier, the hybrid model, we differentiate from the competition because of our ability to serve a broader spectrum of customers including unbanked customers.

Additionally, we are well-positioned to grow national accounts and e-commerce retailers with this platform and will aggressively pursue this largely untapped market. Within our stores in the e-commerce business, we're focused on growing the top line and improving the customer experience. We're taking measures to further optimize the brick and mortar footprint by testing some smaller technology-enabled concept stores and we'll continue to implement cost savings. Expanding into new product verticals such as jewelry and tires and our stores is also expected to tap into a new customer base.

Additionally, we'll continue to invest in our e-commerce platform with online and mobile enhancements to improve the customer experience. Over the past year, we've seen substantial growth from online consumers with higher traffic, growing penetration and improved conversion trends. Online has been our fastest growing channel represents a significant long-term opportunity. Our focus is to serve the lease-to-own customer across multiple channels seamlessly through technology.

As you can probably tell, we're extremely excited about the future. And speaking of being excited, page 10 reiterates what we've previously said we believe we can grow our AcceptanceNOW retail business channel over the next three years. Again by 2022, we expect to grow AcceptanceNOW and Merchants Preferred revenues to over $1.2 billion and annual growth rate of approximately 15% and an increase of approximately $400 million versus the current pro forma combined businesses.

We believe our goals will be achievable given our improved capital position and ability to aggressively sell [ph] to (00:12:33) our respective pipelines. As we move forward, we will leverage the hybrid models, expand into new product verticals, and as I mentioned earlier, put ourselves in position [indiscernible] (00:12:42) more large national retailers. Very, very exciting.

And with that, I will now turn the call over to Maureen for highlights on our financial results.

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Maureen B. Short

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

Thanks, Mitch. Good morning, everyone. I will cover some financial highlights for the third quarter, provide an overview of our capital allocation framework and close with our guidance for 2019 before opening up the call for questions.

During the third quarter, consolidated total revenues were approximately $649 million, 0.7% higher versus the same period of last year primarily driven by a consolidated same store sales increase of 4.5% partially offset by refranchising and rationalization of our store base.

Adjusted EBITDA was $56.6 million in the quarter and EBITDA margin was 8.7%, up 110 basis points over the same period last year.

Non-GAAP diluted EPS was $0.47, up 48.7% over last year. The special items in the third quarter totaled a credit of $5 million which included a GAAP tax benefit related to the reversal of tax reserves for uncertain tax positions partially offset by debt refinancing charges, closure of certain Core US stores and transaction cost associated with the acquisition of Merchants Preferred.

In our Core segment, total revenues in the third quarter decreased 3.3% versus the same period last year primarily due to refranchising efforts and rationalization of the Core US store base partially offset by the same store sales increase of 3.7%.

Store labor and other store expenses decreased by $13.3 million over the same period last year primarily driven by lower store count and cost savings initiatives. Skip/stolen losses in the Core were 4.1% of revenue which is 60 basis points higher than last year. Adjusted EBITDA in the Core was approximately $59 million and EBITDA margin was 13.6%, up 220 basis points versus the prior year.

Now, turning to the AcceptanceNOW segment. Total revenues in the third quarter increased 6.4% primarily driven by the acquisition of Merchants Preferred and a same store sale increase of 6.2%. Store labor and other store expenses increased by $3.9 million over the same period last year primarily due to higher skip/stolen losses which were 8.9% of revenue and in line with our expectations. Adjusted EBITDA in the AcceptanceNOW segment was $22.3 million and EBITDA margin was 12.1%.

Mexico increased revenues by 4.6% in the third quarter and generated $1.3 million in adjusted EBITDA. In the Franchise segment revenue was $15 million and adjusted EBITDA was $1.1 million. Corporate expenses in the third quarter decreased by approximately $4.2 million versus prior year primarily due to the realization of cost savings initiatives.

Moving on to the balance sheet and cash flow highlights. Cash generated from operating activities was $228 million for the nine months ended September 30, 2019. We ended the quarter with $74 million in cash on the balance sheet and $260 million in debt, which was down $20 million since closing on the new credit facility during the quarter.

Our net debt to adjusted EBITDA continued to improve and ended the quarter at 0.8 times. Even with a significant reduction in debt with the refinancing, we have been able to maintain strong liquidity which was $222 million at the end of the third quarter. These results are illustrated in the liquidity and net debt to adjusted EBITDA metric shown in the graph.

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In addition, the company recently reached an agreement in principle to sell its corporate headquarters after running a competitive sale process. Due to the restructuring efforts over the past two years, a significant portion of the building was not being utilized presenting the company with an opportunity to realize material value by selling the building and leasing back at smaller footprint. Net proceeds after taxes and fees are expected to be approximately $35 million and will be utilized to advance the company's stated capital allocation priorities of funding growth initiatives in the retail partner business and returning capital to shareholders.

Slide 14 lays out our capital allocation framework. Our first priority is to continue to invest in the business with a focus on growing the virtual channel. We are committed to maintaining a conservative balance sheet, and we'll take advantage of strategic opportunities as they arise. Through the refinancing and our improved financial performance, we return value to our shareholders through the introduction of a quarterly dividend of $0.25 per share with the first declared in the third quarter and paid out in early October.

As previously communicated, we continue to maintain the flexibility to buy back shares. Regarding our guidance, the company is reiterating and narrowing our annual earnings guidance and increasing our revenue guidance for 2019. I'd also note our guidance does not include the proceeds on the sale of the corporate headquarters. As always, detailed income statements by segment are posted on our company website and the 10-Q for the third quarter will be filed by tomorrow.

Thank you for your time today. Now, I'll turn the call over for your questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Budd Bugatch with Raymond James.

Budd Bugatch
Analyst, Raymond James & Associates, Inc.

Q

Good morning, Mitch. Good morning, Maureen. Good morning, Daniel. Congratulations on a solid quarter. I have a few questions, if I could. Just – yeah, let's just start at the Core with this skips and stolen which were a little elevated from what I expected. I know that you usually get higher skips and stolen in the second half of the year, but the 4.1% I think was just – was higher than I thought about it. Is there anything going on there that consumers are, I mean investors should know?

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

A

No. Good morning, Budd. This is Mitch. I don't think there is. Our range, we want to be in 3s, 3% to 4%, I mean, years and years ago as you see in that recession resistant slide, it was in the 2s, but for the last – for this decade, at least 3% to 4% has been our range. And – so 4.1%, slightly above that, we can't say we're pleased with being a 4.1% because it's outside of that 3% to 4% range, but no, there's nothing there we can execute better. It's really what we're focused on with the operations team and just slightly outside of our range of 4.1%, but no, there is really nothing going on there other than we can execute a little better, certain outlying markets, things like that, they're kind of normal running a business. So we just need to execute better, but there's nothing going on with the consumer there to highlight.

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Budd Bugatch
Analyst, Raymond James & Associates, Inc.

Q

Okay. And getting into the detail in AcceptanceNOW, I noticed that the cost of rental and fees had increased about 300 basis points over the second quarter and 600 basis points year-to-date to like 41.7%, and the pricing multiples actually come down to [ph] 2.4% (00:20:36) . Can you give us an understanding of what's going – and what that looks forward to going forward and is there something going on in that area?

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

A

I think it's the changes to the value proposition we made last year being fully in place, the marketplace with necessary from a value proposition standpoint. The way we look at it but where we – when I came back last year, we cut a lot of overhead out of the business is – we took a lot of overhead out so we can improve the value proposition in both ends of the business. Of course, there's charges in between the companies and when the inventory comes back and all that stuff, so there is some stuff in between the Core and AcceptanceNOW.

But we focus more on the overall EBITDA margin, and when we could cut our overhead, people not serving the customers and some projects we didn't need to do, with the cuts we've made over the last 18 months, improved the value proposition, drive more customers, have the same store sales we're having, and still overall have an EBITDA growth. That's really where we're focused on versus one line or the other. And when we can add 110 basis points of the EBITDA margin overall, we feel better about that. It doesn't mean we're trying to get the losses a little lower in each segment, things like that, or can we tweak the value proposition and get another 10 or 20 basis points, we're always looking to do that. But again overall, we took cost out of business so we can improve the value proposition, so we can get more customers, and it's working. And overall, we're really pleased with 110 basis point improvement on EBITDA.

Having said all that, I don't think they get any worse going forward in the virtual business. Merchants Preferred with more virtual business, you end up with a little lower gross margin, but ultimately you get higher EBITDA because there is [ph] no (00:22:27) labor in the storage. So, we don't get too hung up one line. Like I said, virtual could even lower gross margin more but it's going to raise EBITDA margins over time, overall EBITDA margin, so we're really focused more in the bottom, bottom.

Budd Bugatch
Analyst, Raymond James & Associates, Inc.

Q

I understand that. I just was curious of whether that's kind of a forward way for us to kind of model that particular line, [ph] because (00:22:50) we do model it. And I was also curious, if you could maybe share what the 90-day penetration in AcceptanceNOW in the retail partner program is right now? What's the percentage of 90-day?

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

A

The people that execute?

Budd Bugatch
Analyst, Raymond James & Associates, Inc.

Q

Yes, that execute the 90-day options.

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

Yeah. It's about 0.33. It's about 0.33 of all our rentals end up paying out within 90 or 100 days depending on the retail partner.

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

Okay. And last for me on the balance sheet. Is there a goal now to think about the level of debt, the debt to EBITDA, how to think about the leverage that you're comfortable with? Obviously, the balance sheet has a lot stronger character now than it's had in, God only knows when, but just curious of how to think about that going forward.

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

Budd, this is Maureen. The way we're thinking about the balance sheet is we want to keep the leverage ratio below 1.5 times. And as you can see, we've been below that for the last couple of quarters. So, that – we think of that 1.5 is somewhat of a max of what we would go to given the existing business and after – post refinancing.

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

So, we're well below that. So, you really don't feel any pressure now to reduce debt anymore? We should not just do that or is that what you're looking at it?

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

Well, our priority is to continue to invest in the business. We believe the virtual opportunity will require some investment. And given the return on that investment that we're expecting, that's our number one priority. If we have excess cash from there, then we're potentially paying down debt further just to save on the interest. As you know, the interest – the lower interest from the lower debt balance will be $15 million to $20 million lower going forward, and then we're returning capital to shareholders through our dividend. So those are our capital allocation priorities.

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

Thank you very much. Congratulations. Good luck on the balance of the year and the next year.

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

Thanks, Budd.

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

Thanks, Budd.

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

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Kyle Joseph
Analyst, Jefferies LLC

Q

Hey. Good morning, guys, and thanks very much for taking my questions. First...

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

A

Good morning, Kyle.

Kyle Joseph
Analyst, Jefferies LLC

Q

... [indiscernible] (00:25:12) back on the Core, not looking for any 2020 guidance or anything. But just from a longer term perspective, how you view the growth opportunities there given where you are in terms of store optimization, the refranchising and the overall performance of the business, kind of your long-term outlook for that side of the business.

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

A

Sure, Kyle. Good morning. We are – our big growth vehicle is certainly is virtual and the AcceptanceNOW or the retail partner channel, but we are also very excited about the opportunities we have in brick and mortar, the way the e-com piece of that's growing.

We use our stores as the final mile, if you will, the couple of thousand stores as the final mile for e-commerce, it's grown – as we talked about earlier, depending which specific metric you want to look at has grown in the 20% range. We ended the quarter, as I mentioned, the portfolio up about 3% year-over-year, which is a great indicator of with same store sales going forward. But we – but the way the e-com is, we see it in low to mid-single-digit growth moving forward for a number of years. We think there's an opportunity to keep it where it is again in that low to mid-single-digit same store sales.

There may maybe a little more refranchising as we talked about before, Kyle, and as you know, we're really using a now very opportunistically. The stores have turned around, so we're not just any stores are for sale, things like that. It's more opportunistic, and we're going to – as I mentioned, we're going to test a few in 2020. We tested some smaller footprint stores because e-com is such a bigger part of our business, technology is a bigger part of our business. Can we – as leases turn over, can we prove to ourselves in a test so we can rent a little less space and improve margins that way? It's kind of a long-term view but you got there somewhere.

We only have five-year leases. [ph] So if that work (00:27:18), so we can shrink square footage. It's a five-year plan that can add basis points every year to the mile. So, we're – the way e-com is going and the way web orders continue to grow, we're adding some verticals, as I mentioned, like jewelry and tires testing right now, jewelry and tires in our brick and mortar stores as well as added verticals on the retail partner – in the retail partner channel. So, it's a long answer. I guess the short answer is we continue to believe low to mid-single-digit same store sales in the Core business is doable for a number of years.

Kyle Joseph
Analyst, Jefferies LLC

Q

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No. I appreciate that. That's great color. And at least from a longer term perspective also thinking about credit performance at the Core, obviously, you referenced loss rates used to be in the 2s but that was more than a decade ago. Now, they're kind of the 3% to 4%. How does e-commerce impact the overall loss rates at the Core?

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

A

We've looked about a few times and it's very slight the difference between the e-com customer and the brick and mortar. It is slightly higher. We don't – it's still a matter of executing better the way we approve the orders and so forth, and tweaking the way we approve the orders and so forth. So we're not going to, I don't know what the word is, let more e-commerce business raise that up, we just have to execute better. It is slightly higher, but not enough to say we can expect higher losses going forward. We just need to tweak some of our processes and get them back down under 4%.

Kyle Joseph
Analyst, Jefferies LLC

Q

Got it. That's very helpful. And then, two for Maureen, if you don't mind. Just, Maureen, looking through the press release, I just wanted to make sure that we didn't miss anything, but can you talk about – so we had about [ph] a half a quarter (00:29:11) of Merchants Preferred contribution in the quarter. So just based on the $80 million of rev, is it fair to say that contributed about $10 million to the AcceptanceNOW segment in the quarter?

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

A

Merchants Preferred contributed to the higher revenue within the third quarter for the AcceptanceNOW channel. We're happy with the performance of Merchants Preferred, and that's definitely helping with the revenue growth within AcceptanceNOW.

Kyle Joseph
Analyst, Jefferies LLC

Q

Got it. And then, I know you guys talked about sort of the evolution of disclosures from that side of the business, but just wanted to be – it's pretty clear, but none of the AcceptanceNOW stores, sorry, none of the Merchants Preferred locations were reflected in the AcceptanceNOW store counts in the quarter, right?

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

A

That's correct. Yes, those in the store counts or same store sales, Merchants Preferred is not included in those numbers...

Kyle Joseph
Analyst, Jefferies LLC

Q

Got it. Okay. And then...

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

A

...that time. But as Mitch mentioned – sorry, Kyle. As Mitch mentioned, we'll start tracking things like invoice volume growth, active store count, some of those more virtual type of metrics going forward.

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

And Kyle, let me just add to that. As we – as I mentioned, we added a couple hundred doors just in the couple of months we've had them. As it shows on the slide, about 75 of those were Acceptance – low volume AcceptanceNOW locations. And with those [indiscernible] (00:30:43) you will recall we are running parallel as we're negotiating the acquisition, and we have put our own virtual process out there and we had just put it in a few stores kind of test – and remember we talked about we are testing our own as well. Those were out there in stores not doing any volume yet because we really hadn't put much [ph] meat (00:31:02) behind it once we bought Merchants Preferred, we didn't have a team out there trying to sell. So we converted – 75 of those 200 as the Merchants Preferred, we convert over to Merchants Preferred where they have the team out there going back in the stores and keeping the doors active and things like that. So those 75 were pretty much dormant in AcceptanceNOW because we just rolled them out and they are – it was just kind of sitting there. So that was part – those 75 were part of that 200 growth.

But overall, we're focused on integration, the pipeline is so full that we're still able to get those 200 new locations just in a couple of months since – when you close a deal like that [indiscernible] (00:31:39) that's your priority day one, [ph] is that (00:31:40) we got open doors as you – of course, you're always trying to grow. Well, you put your plan together to grow and integrating and so forth, then that's just the indication of the opportunity there I believe.

Kyle Joseph
Analyst, Jefferies LLC
Q

Great. That's very helpful. Thank you, guys. One last one for me. Maureen, apologies if I missed it, but any timing on the sale-leaseback to the headquarters in the first [indiscernible] (00:32:02) you referenced there?

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

I'm sorry. What was....

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

On the sale-leaseback, the timing.

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

The timing. I'm sorry. The timing will be the end of 2019 or early 2020.

Kyle Joseph
Analyst, Jefferies LLC
Q

Okay. That's it for me. Thanks very much for answering all my questions.

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

Thanks, Kyle.

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

A

Thanks, Kyle.

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

John Rowan
Analyst, Janney Montgomery Scott LLC

Q

Good morning, guys.

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

A

Good morning, John.

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

A

Good morning.

John Rowan
Analyst, Janney Montgomery Scott LLC

Q

I just want to go back into capital allocation a little bit. Where the debt stands now and looking at even just the free cash flow generated to the first time nine months of this year, I mean you're effectively intruding distance of largely bringing your balance sheet of debt and next year if you chose to funnel free cash flow to debt repurchase. I just want to understand something. So, even kind of that dynamic, where is the tolerance for repurchasing stock? I'm trying to figure out where we start modeling in 'cause I think you said your $255 million authorized, I just want to know where that stands in the stack. Next year, if you have $290 million of free cash flow, you pay out $60 million of dividends. How much debt you paid down – how much can you pay down? How much of that debt is a term loan versus revolving? Just walk me through what that looks like next year.

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

A

Yeah. I'll start John and let Maureen get into some of the detail about how the debt split up. But our focus is certainly with the capitals to grow the business. And as we as – with Merchants Preferred to grow it, the virtual business, hybrid business as well to [ph] still some staff growth (00:33:38). And it depends, we need to make sure we have room for especially big partners, big national partners that will take up some cash, some investment, right, as you grow the business. So growth is first and certainly we're committed to the dividend, we have already started that, and share repurchases are on the board. We're not to going to say the number; we just start buying stock yet. But it certainly presents an opportunity depending where the stock is in any particular point in time. As far as how much debt we can pay down and so forth, the split is on a $260 million, it's $200 million and $60 million that you can go to that.

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

A

Right. So we've got a revolver of $300 million and we've borrowed $60 million on that revolver. So we have a lot of flexibility there. And then $200 million on the term loan. And we have a lot of liquidity, and like Mitch mentioned,

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the purpose of that or the reason for having that liquidity is really we've been try to grow that business. But in the near term, if there's opportunities to pay down debt, we'll take advantage of those opportunities to lower the interest rate. But as Mitch said, there's definitely the opportunity to repurchase shares going forward if we choose to do so.

John Rowan
Analyst, Janney Montgomery Scott LLC

Q

Okay. Maureen, what is the blended cost of debt going forward? Obviously, this quarter was the big reduction in the overall debt, I don't want to interpret a rate off of this quarter because it might be off, so what's the ongoing run rate fully baked in, cost of your debt with all the commitment fees and everything rolled up?

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

A

It's around 6%.

John Rowan
Analyst, Janney Montgomery Scott LLC

Q

Okay. And Mitch, you opened the door, so I'm going to walk through it. You talked about large retail partners, large national retail partners. Anything we should know on that front? What does the pipeline look like?

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

A

I think we're gearing up for it after buying Merchants Preferred as far as putting the sales team together specific people just for the large retail partners. And we're just getting started on that. We think there's a great opportunity. There's a lot of large retail partners out there and a lot of [indiscernible] (00:35:53) option yet. And we've got a very unique offering with the virtual through their POS however they want to do it. We've got the resources to do it however the retailer wants to do it. We'll also staff certain stores, all stores, depending on their volume, staff them just on weekend, things like that. So we got the most unique offering in the space and we're optimistic that we're going to be able to find some big large national retailers.

John Rowan
Analyst, Janney Montgomery Scott LLC

Q

Okay. And just last question, Mitch. You talked about the skips and stolens in AcceptanceNOW, and then you made a point about it being better sequentially but obviously it's higher year-over-year. I obviously got the conversation on the – in the in-store number, but is that the right way to look at it? I mean should we be looking at skip/stolens in AcceptanceNOW on a sequential basis or a year-over-year basis 'cause, I mean, obviously, year-over-year the number is still up, but can you remind me again why you may have shifted up to just a higher number at some point over the past year?

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

A

Yeah. I think normally year-over-year, I mean, we look at both anyhow, but year-over-year is certainly a real important metric. We only are pointing out the sequential side it because last year was the outlier. It was just really lower due to the recoveries we had coming off the [indiscernible] (00:37:14), it was just lower than we would normally run. It was on the low side of our [ph] 8-10 (00:37:23) range. In fact, I think there was a quarter or two in there that we were under [ph] 8 (00:37:26).

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So just because last year was so low coming up recoveries that we – because we have booked a big reserve on closing [indiscernible] (00:37:34) and then we have some recoveries. So, last year was low and that's why we're talking about sequentially. But certainly, we don't hide the fact that 60 points higher than last year is just last year was the outlier that's why we point out the sequential side.

John Rowan
Analyst, Janney Montgomery Scott LLC

Q

Okay, that's exactly what I need to know. Thanks, guys.

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

A

Good. Thanks, John.

Operator: Your next question comes from the line of Bradley Thomas with KeyBanc Capital Markets.

Q

Hey. Good morning. This is [ph] Andrew (00:38:08) on for Brad. We were encouraged by the 3.7% comp in the Core segment. I was wondering if you could talk about the components of this and how ticket traffic and collections are trending?

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

A

Yeah, good question. Good morning, [ph] Andrew (00:38:23). We don't get too specific on that but it's traffic, it's e-commerce traffic primarily, but it's traffic growing and it's not -

it's ticket stable but it's not like it's all in pricing where we're just going to get a lot more pricing. Certainly the deflation of electronics makes it hard to get a lot out of ticket. You can get a little more out of furniture and so forth. But overall, its traffic, to answer your question.

From a collection standpoint, actually – probably could have been slightly better but we were within our range where want to be from a collection standpoint. So that's pretty much all traffic on the positive side.

Q

Great. Understood. And then for the upcoming fourth quarter, could you talk a little bit about how you're thinking about promotions? If you could remind us what you're up against last year and how you might go to the market differently this holiday season?

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

A

Well, we, obviously, for competitive reasons, we don't want to get too detailed. But generally speaking, similar to last year, nothing – no need to worry about a [ph] seven, eight-deep (00:39:36) promotions that are really going to drive the revenue down. We don't – again, there's promotions and of course you have Black Friday week and

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things like that as a retailer. But generally, our promotions are different than last year, but from – what you would worry about and how much we're collecting, how much we're giving away, and things like that, pretty much on top of last year.

Q

Okay. Understood. And then my last question is on Merchants Preferred. I was wondering as you talk about the next steps, what are the areas that have been integrated and what areas do you have more work to do?

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

A

Good question, [ph] Andrew (00:40:18). The sales teams have been integrated, but we have more work to do to add to them, which we're in the process of doing, getting a lot of good people hire out there to add to the sales team, the Merchants Preferred, Joe Corona, running Merchants Preferred done a good job adding the sales team, but after we integrated.

The call center is about – we have a smaller call center here, that's about half integrated with one at Merchants Preferred. A few more back office synergy to happen into next year, but it's really the call center and back office is big integration as far as synergies. But on the sales team, basically more people to hire to hit those growth numbers. We're off and running, obviously, as we've already talked about, but we have more salespeople to hire, more – a person or two just focus on large accounts, things like that. So, when I said earlier, [ph] it sees (00:41:18) our timeline. We didn't think we get the sales team in the call centers to integrate quite as fast as we have, and it's going well. The operations team at Merchants Preferred, Mike Dinehart, runs that call center down there, and they've done a great job with the integration. So [ph] we received a higher (00:41:37) – we're in the process of adding more to the team.

Q

Great. That's good to hear. Thank you.

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

A

Thanks, [ph] Andrew (00:41:46).

Operator: Your next question comes from the line of Vincent Caintic with Stephens.

Vincent Caintic
Analyst, Stephens, Inc.

Q

Hey, thanks. Good morning. Another question on Merchants Preferred. So glad to hear that the roll out is going well. And I'm kind of curious, so in terms of the development of the, I guess, the combined product offering, how that's going? And in any of the roll outs you had of that offering to the existing AcceptanceNOW retailers, sort of how has that gone, is there any way to measure, say, the lift that you've had by having the combined offering?

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

A

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I would say the combined offering lift comes next year as we roll it out to some of our current partners and a lot of new partners. So the combined offering really is something that kicks off early next year, pretty much in January, Vincent. And the 200 doors that have opened so far are ready since we've bought Merchants Preferred have been solely virtual. There's a few staffed – fully staffed [ph] miles (00:42:59) opening because of the volume those stores. But the mix, the hybrid, the differentiator, if you will, really starts in January.

Vincent Caintic
Analyst, Stephens, Inc.

Q

Okay, got it. That's helpful. And then so you've highlighted what you've integrated so far for sales, call center, and so forth. At what point do you think you'll have all of that ready? And I guess the fundamental part of the question and then a lot of investors been asking is at what point, particularly because it seems like retailer appetite is strong, at what point are you ready to be able to operationally have a national retailer trial going on?

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

A

We'll be ready in the next 60 days. We'll be ready for a national retail trial the first of the year.

Vincent Caintic
Analyst, Stephens, Inc.

Q

Okay. Great. Separate question, but kind of related to the prior fourth quarter question. Just wondering as we're getting into holiday sale season, is there anything different for this year in particular just trying to get a sense of how you're seeing the consumer, if it's the consumer as strong as they were last year, if there's any nuances on what they're particularly looking for as we're going into the holiday sale season? Thanks.

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

A

Yeah. Good question. We're seeing it just as strong – I'm sure we'll hear about the comps being a little lower than last year, but that's really a measure of what we're [ph] camping (00:44:33) over last year versus what we're [ph] camping (00:44:35) over this year. That's why we talked about the two-year number in both the Core and the retail partner channel, the AcceptanceNOW segment, if you will. And when you look at the two-year, whether you look at the Core or the ANOW segment, it just continues to perform. So, the customers there, strong.

Nuances, as far as what they're looking for, no, we haven't – more putting their order in online every day versus coming into the store. I think it's just the way people shop and we're there for them wherever they want to shop. They don't have to come into a store to do business with us. They can do it all from the comfort of their home, and like I said earlier, we used our couple thousand brick and mortar locations as a final mile in the course side, but they don't have to come in, and more and people are doing and letting us take care [indiscernible] (00:45:23) in their home versus coming in the store. But other than that, there's really no trend as we go.

Vincent Caintic
Analyst, Stephens, Inc.

Q

Got it, very helpful. Thanks very much, Mitch.

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

A

Thanks, Vincent.

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

Anthony Chukumba
Analyst, Loop Capital Markets LLC

Q

Good morning. Thanks for taking my questions. Just in terms of the 125, I guess, doors that you rolled out on Merchants Preferred, excluding the 75 that [ph] were in (00:45:56) conversions from AcceptanceNOW doors. Can you give us any color just in terms of those doors, like any particular vertical or verticals or is that sort of one chain or few chains? I just wonder if we get any color on that. Thanks.

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

A

Yeah. Good question. It was primarily still in the furniture business as we think about newer verticals like jewelry and tires, and we're looking at those in both of the Core business and the virtual business as well as some others that we aren't testing yet. But it's pretty much been furniture so far, no big retailers and there are just a lot of local regional players building up the – Merchants Preferred had a bit of a pipeline to begin with, and without the capital they will really take advantage of it. So, a lot of it is just [indiscernible] (00:46:45) find the people [indiscernible] (00:46:47) signed up before. So, pretty much still on the furniture space for now, Anthony, to answer your question.

Anthony Chukumba
Analyst, Loop Capital Markets LLC

Q

Got it, thanks. And then just one follow-up question, could you just remind us how does Merchants Preferred currently handle I guess return merchandize? And do you see that changing at all going forward?

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

A

Yeah. They have a few different ways on return merchandize to get rid of it through online methods of getting rid of it some – primarily that selling it online and things like that. We're – certainly, in our brick and mortar footprint, we'll be able to improve on that and be able to not only help the collection side of things, but help maximize the value of some of those returns to our brick and mortar stores like we do on the AcceptanceNOW side.

Anthony Chukumba
Analyst, Loop Capital Markets LLC

Q

Got it. That's helpful. Thank you.

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

A

Thanks, Anthony.

Operator: Your final question comes from the line of John Baugh with Stifel.

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

Q

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Thanks. Good morning. Congrats on the solid results here. I'll jump right in. You, to an earlier question, Maureen, didn't seem to want to go into the Merchants Preferred P&L impact on Q3 in terms of either revenue or maybe the expense side and EBIT impact. But should we then look at Q2 and then compare it to Q3 and sort of make interpolations that way or is there any kind of help there?

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

A

Yeah, John, we're trying not to differentiate now between the segment with Merchants Preferred mix up and AcceptanceNOW. We see it as one segment going forward. We talked about the annual revenue expectation for Merchants Preferred being in that $80 million range. So that hasn't changed based on what we're seeing the door count. I think growth reflects around a little bit higher than we expected. So, hopefully, that provides enough color to be able to model the Merchants Preferred impact.

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

Q

Okay. And then Mitch, I may be mistaken or my memory may be off, but I thought last time we talked about Merchants Preferred and the sort of opportunity which I think you identified as $400 million pro forma that it would be more local regional, there's a lot of talk on this call about the national accounts. So maybe I just start there, has something changed or would the expectation [ph] be you're going to win (00:49:22) a lot that $400 million at least in the initial years it's going to be the smaller regional local guys?

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

A

No, I think you remember it right, John. The $400 million – the $800 million of revenue going up to $1.2 billion over the next three years is not dependent on – with large national retailer, now that would be actually additive to that. We think we can do that with regional players, obviously, some larger regional players and a lot of regional players in general, obviously, for that kind of growth. But there's not a national player in there, it's just another avenue of growth, but that growth we've laid out for the next three years is not dependent. So like if we don't get one of the big guys, we're not going to hit those numbers. So I think your memory is accurate and that the large retail partner opportunity is just in addition to what we've already talked about.

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

Q

Okay. And then you commented around the 90-day being around the third, is that trending up in what's been a pretty good economy here? Do you see that number in general moving higher?

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

A

No, it's been pretty flat. It's been pretty flat.

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

Q

Okay. And in terms of pricing, are we still in a 2.1 times range on the sort of the ANOW side of the world? Are there any terms with discounts or pricing approval rates, et cetera, that you're promising retailers? Is any of that moving in one direction or the other?

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

A

No, not really. It's still in the low 2s. The 2.1 range like you said, the – it's more competitive out there, and you do end up having the – impacting margins through the deal you make with the retail partner and so forth. But I wouldn't say it's trending any differently than it has last year or two. It's been competitive out there and that has some impact on the margins on how you pay the retailer and so forth. But no, nothing in the last quarter or anything like that's changing.

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

Q

Okay. Great. Thanks. Good luck.

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

A

Thanks John.

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

A

Thanks, John.

Operator: There are no further questions. Mr. Fadel, you may proceed with any closing remarks.

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

Thank you very much, and thank you everyone for your time this morning. On behalf of all of us, the whole leadership team and everybody here at Rent-A-Center, I want to thank all of you, all of our co-workers, our retail partners and our franchisees. We thank all of you, and we look forward to executing our growth plan and building on our solid foundation. Thanks again, everyone.

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

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