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Rent-A-Center, Inc. (RCII)

Q2 2018 Earnings Call

CORPORATE PARTICIPANTS

Daniel O'Rourke
Vice President - Finance, Investor Relations and Treasury, Rent-A-Center, Inc.

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

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

OTHER PARTICIPANTS

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good morning and thank you for holding. Welcome to Rent-A-Center's Second Quarter Earnings Conference Call. As a reminder, this conference is being recorded, Tuesday, July 31, 2018. Your speakers today are Mr. Mitch Fadel, Chief Executive Officer of Rent-A-Center; Maureen Short, Interim Chief Financial Officer; and Daniel O'Rourke, Vice President of Finance, Investor Relations, and Treasury.

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

Daniel O'Rourke
Vice President - Finance, Investor Relations and Treasury, Rent-A-Center, Inc.

Thank you, Christie. 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 second quarter of 2018. 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 call over to Mitch.

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

Thank you, Daniel, and good morning, everyone. Thank you for joining us. On June 18, it was announced that Rent-A-Center would be acquired by Vintage Capital for $15 per share, which represents a sizable premium over the company's stock price prior to the announcement.

This premium reflects the significant progress we've made to materially improve our performance. The preliminary merger proxy statement and the SEC filings were completed on July 16th and the transaction is expected to close by the end of the year, subject to receipt of stockholder and regulatory approvals. We look forward to partnering with Vintage to realize the full benefits of the transaction.

And now on to the second quarter results. As you can imagine and as we've said in the press release, I'm extremely pleased with both our top-line and bottom-line performance for the quarter. All operating segments had positive same-store sales and all segments improved sequentially throughout the quarter as well. The Core segment improved sequentially for the sixth consecutive quarter with same-store sales of 3.5% in the second quarter.

Strong portfolio performance continues and we generated positive customer growth in the second quarter – sequentially in the second quarter for the first time in over a decade. The pricing and value proposition changes within the Core and the Acceptance NOW business have helped us to achieve sustainable revenue improvement in both businesses by increasing demand and retention.

Regarding the bottom-line, in the second quarter the company generated approximately $61 million in adjusted EBITDA and approximately $58 million in cash flow from operations, which are significantly above our expectations and significantly above last year.

Through the execution of our cost saving initiatives, we continue to make significant progress to strengthen our financial profile and drive near term profitability and cash flow. During the quarter, we exited our third-party distribution center network and reverted back to a direct-to-store supply chain as well.

This is expected to generate significant working capital reductions by lowering our idle product levels and reducing our distribution costs. Overall, those cost saving initiatives continue to run significantly ahead of our original plan with over $100 million expected in annual ran rate savings and approximately $70 million expected to be realized this year.

We continue to track all of the previously implemented initiatives and we've not seen any material disruptions in the business either.

So, our strong financial results and the announced transaction that I mentioned at the start would not have been made possible without the hard work and focus of our talented co-workers over the last several months, and I'd like to thank all of our coworkers for their contributions in our turnaround and for all you do for our great customers every day.

With that update, I'll now turn it over to Maureen and she'll go through the financials for the second quarter.

Maureen B. Short

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

Thanks, Mitch. Good morning, everyone. I'll cover our second quarter financial results in more detail and the financial information I speak to will be excluding special items.

During the second quarter of 2018 consolidated total revenues were $655.7 million, down 3.2% versus the same quarter of last year, primarily due to store closures. Same-store sales for the consolidated business were positive 3.7% and improved sequentially and each month within the quarter and across all operating segments. Adjusted

EBITDA was $61.1 million in the quarter and EBITDA margin was 9.3%, up 500 basis points over the same quarter last year.

Net diluted profit per share excluding special items was $0.47. The special items charges taken in the quarter were $16.5 million, primarily driven by charges related to our cost savings initiatives and the strategic alternatives review process our board began last October. Also included in the $0.47 per share were non-recurring charges totaling approximately $8 million or $0.11 per share, driven by insurance adjustments in vehicle sales. Excluding these non-recurring items, net diluted profit per share excluding special items would have been approximately $0.36.

In our Core segment, total revenues in the second quarter decreased 0.3% versus the same quarter last year, primarily due to store closures and partially offset by same-store sales of positive 3.5%. This is the sixth consecutive quarter of sequential same-store sales improvement and a 320 basis point improvement versus the first quarter of this year. Gross profit margin was 71.4%, an increase of 180 basis points over the same quarter last year, primarily due to the intercompany book value adjustment on returned Acceptance NOW products and value proposition enhancements.

Store labor expense in the Core was down $5.8 million and other store expenses were down $6.8 million, primarily driven by a lower store count and non-recurring insurance and vehicle sale benefits. Skip/stolen losses in the Core were 3.1% of revenue, which was 70 basis points higher than the same quarter last year and flat sequentially versus Q1. Adjusted EBITDA in the Core segment was $61.2 million and EBITDA margin was 13.4%, which was up 470 basis points versus the same quarter last year and 510 basis points sequentially.

Rental merchandise on rent in the Core business increased $3 million versus the same quarter last year and held-for-rent or idle inventory decreased approximately $46 million, primarily due to working capital initiatives.

Now turning to the Acceptance NOW business, total revenues in the second quarter decreased by 12% from the same quarter last year primarily due to the Conn's and HHGregg's store closures in 2017 and partially offset by same store sales of positive 3.7%. Gross margin in Acceptance NOW was 48.1%, down 300 basis points from the same quarter last year, driven by the intercompany book value adjustment on returned Acceptance NOW products and the value proposition enhancements. Store labor expense was down $9.8 million and other store expenses were down $13 million versus the same quarter last year, primarily due to a lower store count, lower losses and the closure of the collection centers.

Skip/stolen losses for Acceptance NOW were 7.7% of revenue, which was 170 basis points better than the same quarter last year and 120 basis points better sequentially. Adjusted EBITDA in the Acceptance NOW segment was $29.7 million and EBITDA margin was 16.6%, which was up 400 basis points versus last year and up 630 basis points sequentially.

Corporate operating expenses in the second quarter decreased $5.1 million compared to prior year, primarily due to the realization of cost savings initiatives. Excluding the impact of accruals for higher expected incentive compensation, Corporate operating expenses decreased approximately $7 million compared to prior year.

Regarding the balance sheet, during the first half of 2018, the company generated $142.9 million of cash from operations and reduced debt by $98.2 million. We ended the quarter with $116.8 million in cash on the balance sheet and approximately $584 million in total outstanding debt.

The fixed charge coverage ratio for the second quarter was 1.15, which met the requirement of at least 1.1 under our credit facility and eliminated the $50 million reserve requirement this quarter. Total available capacity on our $350 million revolver at the end of Q2 was approximately $245 million, taking into account our committed letters of credit. Total liquidity including the $117 million of cash on hand at the end of the quarter was over $360 million. Since the end of the quarter, the $41.1 million in term loans remaining under our credit facility were repaid in full and our outstanding debt which now only includes our senior notes is $542.7 million.

Lastly, the company is no longer providing guidance due to the pending Vintage Merger.

Now, we will open up the line for any questions you may have.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from Budd Bugatch with Raymond James. Please go ahead.

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.

Q

[indiscernible] (10:42) congratulations on the better results. I guess my really only question since you're not providing guidance is, do we have any update on when you might be issuing a proxy for the shareholder vote? What's the outlook for that?

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

A

Well, we filed – good morning, Budd. This is Mitch.

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.

Q

Good morning.

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

A

We filed a preliminary proxy as we said on July 16 with the SEC. So, it's a matter of hearing back from the SEC and then getting that into a definitive proxy. So, it's filed, and we're just waiting on the SEC at this point to turn it from preliminary – just based on their comments from preliminary into definitive to send out to the shareholders.

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.

Q

And what other regulatory approvals do you need to close the transaction?

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

A

Well, government is really – I mean, I'm not the attorney on this deal. But, I mean, the government one is the big one. And in that more specifically, the FTC approval and that's been filed, and we're in the waiting period on that as well.

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.

Q

Okay. And I guess the last question for me is your – one of your chief comparable has disclosed in their latest filing that they had received a request from the FTC for some information and questions to be answered. Have you received a similar request?

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

A

No, we have not.

Beryl Bugatch
Analyst, Raymond James & Associates, Inc.

Q

Okay. All right. Thank you. Thank you very much. Good luck, and we'll stay tuned for the proxy file.

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

A

Okay. Thank you, Budd, and thanks for all your coverage over the years and all your support.

Operator: [Operator Instructions] There are no questions at this time.

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

Well, thank you, Christy. And thank you, everyone. We didn't – I mean, not surprised. We didn't expect a lot of questions based on being between sale announcement and closing sometime by the end of the year, so. But it was a good quarter for us. We'll just continue to work hard and continue to improve our results. Look forward to working with Vintage to maximize the opportunities still in front of us. And we'll see if we're reporting back to you in a quarter or not. Obviously depends on the closing. But again, we appreciate and thank you for your time this morning and we'll talk soon. Thank you.

Operator: Thank you for joining. This concludes today's conference call. You may now disconnect.