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RCII - Q1 2018 Rent-A-Center Inc Earnings Call

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OVERVIEW:

Co. reported 1Q18 consolidated total revenues of $698m and net diluted loss per share, excluding special items of $0.08.

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PRESENTATION

Operator

Good morning, and thank you for holding. Welcome to Rent-A-Center's First Quarter Earnings Conference Call. As a reminder, this conference is being recorded, Tuesday, May 1, 2018.

Your speakers today are Mr. Mitch Fadel, Chief Executive Officer of Rent-A-Center; Ms. Maureen Short, Interim Chief Financial Officer; and Mr. 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, sir.

Daniel B. O'Rourke - *Rent-A-Center, Inc. - VP of Finance Analytics & Reporting*

Thank you, Regina. Good morning, everyone, and thank you for joining us. Our earnings release was distributed after market close yesterday, which outlines our operational and financial results for the first quarter of 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 - *Rent-A-Center, Inc. - CEO & Director*

Thank you, Daniel, and good morning, everyone. Thank you for joining us.

Over the past few months, the company has been diligently executing on our strategic initiatives, and I'm pleased to say considerable progress has been made. As I mentioned on our last call, our strategy is built around aggressively addressing a number of controllable items to drive near-term profitability and cash flow. And value proposition enhancements are also part of our strategy to increase demand and achieve sustainable revenue improvement in both the Core stores and the Acceptance Now business. And the first quarter results demonstrate the progress that's been made in both the top line and bottom line.

In the first quarter, we generated positive same-store sales across all operating segments. Now achieving positive same-store sales in the quarter is a key milestone for the company and an important step towards building sustainable profitability in the segment. It was the first time since the second quarter of 2015 that the Core was positive, again a real milestone event. This was primarily driven by a strong portfolio performance, and the Core same-store sales improved sequentially throughout the quarter, growing to plus 1.6% in the Core in March.

As many of you know, the portfolio is made up of our customer agreement count, multiplied by the average ticket. The rental agreement portfolio in the Core business same stores ended the first quarter about $3.3 million ahead of last year. In our business, the portfolio balance is a leading indicator of future performance. In a portfolio business like ours, the $3.3 million we are ahead at the end of March, at the end of first quarter, rolls forward each month through the rest of the year, assuming we hold on to that variance.

So for the remaining 9 months of the year would translate to about $3 million a month in collected revenue or about another $27 million top line benefit. Minus some merchandise depreciation costs, and you get about $20 million benefit to EBITDA, again, if the portfolio variance holds.

Now the portfolio can move up or down every month, depending on performance, but our Q1 results give us comfort about the positive trajectory of the business and continued positive same-store sales improvements in the quarter. And also, those positive Q1 results continued to build through April.

Pricing was adjusted in both lines of business in the first quarter, which is expected to further increase demand in ownership. In the Core business, pricing on elastic products were lowered and offset by inelastic product pricing changes. Additionally, the level of free time promotional activity in the Core was also significantly reduced in Q1, contributing to our positive same-store sales as well.

In Acceptance Now, the value proposition was changed to include shorter terms and a slightly higher average ticket. These changes are expected to increase our conversion rate, drive higher ownership and allow us to recoup our product investment faster. Additionally, in Acceptance Now, we're in the process of making changes to our initial payment programs, and we're seeing a significant increase in demand where we have started that program.

All of these changes have made us more competitive with our pricing, resulting in a better everyday offer for our customers and, as I've said, are increasing demand for our product in the kiosk space.

Regarding bottom line performance. In the first quarter, the company generated approximately $25 million in adjusted EBITDA and approximately $85 million in free cash flow. This is a significant improvement, and most of our cost-savings initiatives were not even implemented until late in the quarter or even into April.

Regarding the progress made on those cost-savings initiatives, in early March, corporate overhead was reduced by approximately 250 positions or about 25% of the corporate office, resulting in annual run rate savings of about $28 million, with $20 million expected to be realized this year.

In April, leadership in the field has been realigned and reduced by about 60 positions. These changes are expected to generate $9 million in annualized run rate savings, with about $6 million realized this year. Between the corporate and field reductions, we're on track to meet the $30 million to $40 million of annualized overhead savings outlined in our 2018 guidance.

Other store expense savings primarily includes cost rationalization in the Core stores by negotiating better rates and rationalizing levels of service by our procurement department. Targeted savings of about $15 million annually have been identified, with 20% of those savings already realized. These initiatives are not expected to disrupt the business since the opportunities are primarily outside of operations, but they'll allow us to be much more efficient as an organization.

Moving to our supply chain initiatives. During the first quarter, several changes were made to our supply chain. Within Acceptance Now, we've historically utilized collection centers to pick up returned product and perform late-stage collection activities.

During March, all Acceptance Now collection centers were closed, and the responsibilities were transferred to nearby Core store locations. Minimal hours are expected to be added to the Core stores since the returns in the Acceptance Now business are very low.

The reduction of coworkers, vehicle and rent expense from the collection centers are expected to generate annual run rate savings of over $25 million, net of the minimal increased labor expense in the Core, with approximately $20 million realized this year.

Also related to our supply chain initiatives, we made other moves around our inventory that impact our profit and cash flow in 3 ways: first, we rightsized the inventory in the first quarter, which resulted in a onetime working capital benefit of about $25 million. We also made the decision to exit our third-party distribution centers and move back to using a direct-to-store model, augmented by our own product service centers. We believe this will be a seamless, nondisruptive change as we're basically going back to the way we did it for years.

Now this will help us in 2 additional ways. One, we estimate this will result in about $12 million in annualized working capital reduction and cost-of-goods run rate savings, with about half of that realized this year. And second, we'll incur a onetime working capital benefit of about $15 million due to the elimination of those third-party DCs.

So 3 impacts to inventory management: we rightsize the store inventory, we pay less for our product based on the distribution changes and we free up working capital from product not sitting in the DCs.

And the last point on the supply chain initiatives that we implemented this quarter is the optimization of routes for our 21 product service centers, resulting in annualized run rate savings of about $7 million, with $5 million realized in 2018. So when you add up all the supply chain initiatives, we're now up to $35 million to $40 million in annual cost savings and between $40 million and $45 million in this year's working capital benefits just on the supply chain initiatives.

Overall, the company is ahead of our plan and our EBITDA-enhancing opportunities. And we now expect those cost savings to be in the $75 million to $95 million range, with about 2/3 of that being realized this year, with additional working capital benefits in 2018 of $40 million to $45 million. So when you add the annual cost-savings number to the working capital numbers, this is adding up to a plan in the range of $115 million to $140 million.

And we're -- so we're raising our EBITDA-enhancing numbers, yet we missed the consensus earnings estimates for the first quarter. So obviously, our spread of earnings is a bit different than our analyst. But suffice it to say, we're running ahead of our plan and feel really good about where our profit numbers are heading.

Growing the franchising business is another initiative that is gaining ground. During the first quarter, the company completed its transaction with an existing franchisee to refranchise 31 Core locations. Without formally marketing Rent-A-Center's franchise opportunity, there's an increasing number of potential franchisees interested in partnering with us for similar-sized, large refranchise transactions.

The franchise opportunity enables the company to maintain and grow our brand presence through development agreements and utilize proceeds on the sale of the stores to improve our balance sheet. We'll continue to pursue refranchising opportunities, pending the outcome of our strategic review as well as the store rationalization plan of closing approximately 150 underperforming stores in 2018.

While the strategic alternatives review process remains ongoing, the changes we have made to the business were also necessary to better position the company for long-term growth and profitability.

I look forward to building on our momentum from the first quarter performance and strongly believe there is a significant opportunity, a lot more opportunity to continue to improve the profitability and cash flow of the company.

I'd like to thank all of our coworkers for their contributions in our turnaround and for all they do to help our great customers out every day.

Now Maureen will walk through the financials for the first quarter.

Maureen B. Short - *Rent-A-Center, Inc. - Interim CFO*

Thanks, Mitch. Good morning, everyone. I'll cover our first quarter financial results in more detail and provide an overview of our balance sheet. All of the financial information I speak to will be excluding special items.

During the first quarter of 2018, consolidated total revenues were $698 million, down 5.9% versus the same period of last year, primarily due to store closures.

Same-store sales for the consolidated business were positive 0.8%. Adjusted EBITDA was $25.1 million in the quarter, and EBITDA margin was 3.6%, up 490 basis points sequentially. Net diluted loss per share, excluding special items, was $0.08.

The special item charges taken in the quarter were $17.5 million, which included approximately $10 million in onetime expenses related to our cost-savings initiatives, driven largely by severance costs.

In our Core segment, total revenues in the first quarter were down 1.8%, primarily driven by store closures. Same-store sales in the Core segment were positive 0.3%, driven by better collections from lower promotional activity and the higher portfolio balance due to an increase in the average ticket. This is the fifth consecutive quarter of sequential same-store sales improvement and a 390 basis point improvement versus the fourth quarter.

Gross profit margin was 69.8%, an increase of 100 basis points over last year, primarily due to the intercompany book value adjustment on returned Acceptance Now products. As we mentioned during our last earnings call, this intercompany adjustment results in the Core no longer being negatively impacted by the excess inventory cost of Acceptance Now product purchased at retail instead of wholesale rate and will not impact the consolidated financials.

Store labor expense in the Core was down $2.4 million, driven by lower store count. Other store expenses were down $7.2 million, driven by a lower store count and timing related to advertising expenses.

Skip/stolen losses in the Core were 3.1% of revenue, which was flat to last year. Adjusted EBITDA in the Core segment was $40 million, and EBITDA margin was 8.3%, which was up 160 basis points versus last year and 430 basis points sequentially.

Now turning to the Acceptance Now business. Total revenues decreased by 16%, primarily due to the Conn's and HHGregg store closures, partially offset by higher same-store sales of 3.3%.

Gross margin in Acceptance Now was 45.1%, down 370 basis points from the prior year, driven by the intercompany book value adjustment on returned Acceptance Now products, discounting early payout amount to encourage ownership and the new value proposition changes.

Labor was down $8.7 million, and other store expenses were down $5.6 million versus last year, primarily due to a lower store count. Skip/stolen losses were 8.9% of revenue, which was 50 basis points better than last year and 480 basis points better sequentially.

Credit metrics in the Acceptance Now business also improved throughout the quarter. Adjusted EBITDA in the Acceptance Now segment was $20.3 million, and EBITDA margin was 10.3%, which was down 290 basis points versus last year and up 740 basis points sequentially.

Corporate operating expenses increased $6 million compared to prior year, primarily driven by a onetime benefit in Q1 of last year from the reversal of unvested stock compensation previously granted to former executives. Since the corporate overhead cost-savings initiative took place in late Q1, we did not see material benefits within the quarter.

Regarding the balance sheet. During the first quarter of 2018, the company generated approximately $85 million of cash from operation, reduced debt by approximately $78 million and ended the quarter with $604.4 million in total outstanding debt and $81.4 million in cash and cash equivalent. The revolver balance was reduced by $65 million in the first quarter and ended the quarter at $20 million drawn.

Total available capacity on our $350 million revolver at the end of Q1 was approximately $180 million, taking into account the $50 million reserve necessary, given the fixed charge coverage ratio, and approximately $100 million in letters of credit.

Total liquidity, including the $81 million of cash on hand at the end of the quarter, was over $260 million. Since the end of the first quarter, we have received our $10 million tax refund, paid down the revolver by $20 million and currently have no outstanding balance on our $350 million revolver. In addition, during 2018, we believe cash flow generated from operations will be sufficient to fund the business.

Regarding guidance for 2018. As stated in our release issued earlier this month, we have increased our free cash flow guidance from at least $130 million to at least $170 million.

Revenue, cost savings and working capital initiatives are all exceeding management's expectations. The total cost-savings initiatives are now expected to generate $75 million to $95 million of annualized savings, up $10 million from previous guidance, with 2/3 of the total still expected to be realized in 2018.

Overhead annualized savings of $30 million to $40 million and other store expense savings of $10 million to $15 million remain unchanged from previous guidance. Working capital initiatives are now expected to generate $40 million to $45 million of benefits, up $20 million from previous guidance. And supply chain initiatives are expected to generate $35 million to $40 million, up $10 million from previous guidance.

Now we will open up the line for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question will come from the line of Budd Bugatch with Raymond James.

Beryl Bugatch - *Raymond James & Associates, Inc., Research Division - MD and Director of Furnishings Research*

I guess I would just cut to the cost savings and try to pen what might have been affected in quarter 1. You said it wasn't material. My guess was somewhere around $3 million of the adjust -- or the projected cost savings. Maybe you can help give us that number.

Maureen B. Short - *Rent-A-Center, Inc. - Interim CFO*

That's probably not far off, but I don't have that exact number in front of me. It's probably closer to $2 million to $3 million in that range. Since the overhead savings happened in March, I guess early to mid-March, there wasn't a lot of savings that occurred, but that's probably a good estimate.

Beryl Bugatch - *Raymond James & Associates, Inc., Research Division - MD and Director of Furnishings Research*

So that -- sorry, go ahead.

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

Sorry, Budd. It's very little, and that's why I made the comment that our -- even though we're raising our numbers, it's not much of an impact in the first quarter, and that's why our spreads is a little different than the analysts' spreads out there. As we're raising our numbers, yes, we missed the first quarter consensus estimates, but...

Beryl Bugatch - *Raymond James & Associates, Inc., Research Division - MD and Director of Furnishings Research*

Yes, well, guilty as charged.

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

Obviously, our spreads is a little different.

Beryl Bugatch - *Raymond James & Associates, Inc., Research Division - MD and Director of Furnishings Research*

Well, I understand. But that would imply something close to $20 million a quarter for each of the next 3 quarters, maybe with the second quarter being a little bit light because you're still implementing some actions?

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

That's right. That's right.

Beryl Bugatch - *Raymond James & Associates, Inc., Research Division - MD and Director of Furnishings Research*

Okay. And then, are there any other actions that you can talk about that are contemplated? I realize that's sensitive that you've got people involved in those actions, but should we expect more actions or more significant actions in the next couple of quarters?

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

I don't think in the next couple of quarters, we will, Budd. We certainly focus on the things -- there are more things on the list. We pick the things we could get done this year, and we're executing on them, running a little ahead of plan. There are other things on the list. It's probably -- probably, not things that we'll get to that will impact this year be more of an impact on next year.

Beryl Bugatch - *Raymond James & Associates, Inc., Research Division - MD and Director of Furnishings Research*

Okay. And you said, I think, $170 million of free cash, and you've already had $85 million of that. Does that mean that debt goes down by another $85 million by the end of the year? Or is that the right way to look at it? Or is it -- maybe, is it more?

Maureen B. Short - *Rent-A-Center, Inc. - Interim CFO*

Well, the debt -- the revolver is fully paid off, and so the $170 million that we generate in free cash flow will be enough to sustain operation, to implement our cost-savings initiatives, and we'll use what we can to pay off debt. But with the revolver already paid off, there's not a lot more that we plan to pay off when it comes to debt throughout the year. We're working on our refinancing plan. And depending on -- once we have the outcome of the strategic alternatives review process, we'll move forward with that.

Beryl Bugatch - *Raymond James & Associates, Inc., Research Division - MD and Director of Furnishings Research*

Okay. And just a couple of other quick ones from me. You talked about 150 stores, I think, in the Core being closed this year. How do we look at that versus what's been franchised, what's been merged? Help us out to what kind of maybe an ending Core number is or maybe what -- how that flows through the year?

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

Well, the 150 is separate from the 31 that we sold to the -- to our existing franchisee in the first quarter. And you might recall, by the last quarter, we estimated more like 175. And as we've gone through store by store and business is improving, that number is actually a little lower, the 150 versus what we said last quarter due to the business getting a little better. And as we analyze what stores to close, we're down to 150, they're pretty well-spread over the year with a bit of front load. There's about -- if you look at in our current press release, there was 62 merged, what's that, in the first quarter. But the location for the -- at the end of the year, down -- well, yes, I'm just looking at the press release. So about 60 merged in the first quarter, so there's about another 90 to go, and that would leave us about 2,200 stores right at the end of the year.

Beryl Bugatch - *Raymond James & Associates, Inc., Research Division - MD and Director of Furnishings Research*

Got you. Okay. And just lastly from me, if you could kind of give us what the comp base is for ANow? That's an area where it's been really challenging to kind of get, for us at least, to get the revenues right. So how do we think about that?

Maureen B. Short - *Rent-A-Center, Inc. - Interim CFO*

The store count included in the same-store sales number for Acceptance Now is still a fairly small number compared to the total. So -- and those stores, as you know, have trended a little bit more favorable than the overall average. There are numerous locations, so that still applies this quarter.

Operator

Your next question will come from the line of Kyle Joseph with Jefferies.

Kyle M. Joseph - *Jefferies LLC, Research Division - Equity Analyst*

I just want to make sure we're apples-to-apples on the free cash flow guidance, just given how off the analysts were this quarter. Apologies for that. Anyway, in terms of the free cash flow guidance, would that include sales proceeds from the franchising? And would severance be in there as well?

Maureen B. Short - *Rent-A-Center, Inc. - Interim CFO*

Yes. Included in the 170, the at least 170, would be the proceeds from the sale to the -- or the sale of the franchise, refranchised stores as well as any severance incurred for the cost-savings initiative.

Kyle M. Joseph - *Jefferies LLC, Research Division - Equity Analyst*

Okay, that's helpful. And then just going over to Acceptance Now, I know Budd touched on it, but it looks like credit improved there. How much of that is being driven by just lapping the Conn's and HHGregg closures? How much is the new sort of the new pricing you're rolling out, the new pricing model you're rolling out there? Can you just give us some color on what's going on there?

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

Sure, Kyle. Yes, I don't think much of it is lapping Conn's and HHGregg, not the first quarter at least, because we got out of HHGregg towards the end of last year and Conn's sort of at the end of the first quarter. So we're in those stores we hadn't exited on for most of the first quarter last year. When we look at ourselves sequentially, the numbers in the first quarter have gone down every month from a collections and a loss standpoint. So I think there's just a lot of improvement, probably primarily split between execution and the value proposition changes. Shorter terms will make a very big impact in the way that business operates, and I think we're already seeing some of that.

Kyle M. Joseph - *Jefferies LLC, Research Division - Equity Analyst*

And then on the closure of the Acceptance Now collections facilities, do you anticipate any sort of impact on credit performance there? Or do you think the stores can make up for that completely?

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

I think, if anything, it will get better. The stores -- the better job -- the stores will do a better job collecting them what we're doing in collection centers. So if there's any impact, it will be on the positive side. Besides the cost savings, obviously, it's a huge impact. But if there's any operational impact, I believe it will be positive based on the stores. The stores are pretty good at collecting.

Operator

Your next question comes from the line of Brad Thomas with KeyBanc Capital Markets.

Bradley Bingham Thomas - *KeyBanc Capital Markets Inc., Research Division - Director and Equity Research Analyst*

Let's see here. I wanted to zoom in to ANow first, if I could. Obviously, we've known about the loss of HHGregg and Conn's here for a number of quarters. The first quarter revenues in ANow did come in worse than what I've been looking for and probably others. I guess, was there anything unusual about 1Q in terms of the early payouts? And is this run rate kind of down mid-teens, where revenues in ANow would be tracking for Q2 at this point?

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

I think -- no, there's nothing unusual about the ownership levels. It's normal. They're higher certainly in the first quarter because of income tax refund, so that was normal. I think the -- I don't have the spread in front of me, but I think with the first quarter of last year being the last quarter we're in those stores, the deficit against Conn's and HHGregg would subside as the year goes on.

Bradley Bingham Thomas - *KeyBanc Capital Markets Inc., Research Division - Director and Equity Research Analyst*

Got you. Do you think 1Q would be sort of the worst quarter? Or -- I mean, just to try to get our models aligned better with how you guys are looking at the business. Do you think revenues in ANow decline at a lesser rate in 2Q? Or could things continue to get worse in 2Q as we keep lapping some of these tough comparisons?

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

No, I think, absolutely, the former, what you said, the first quarter being the last -- first quarter of 2017 being the last quarter we're in Conn's and HHGregg for the majority of it, the first quarter of this year lapping against that certainly appears and with pretty good certainty from my standpoint that that's the worst number we'll see.

Bradley Bingham Thomas - *KeyBanc Capital Markets Inc., Research Division - Director and Equity Research Analyst*

Got you. And then just to wrap up the line of conversation on this. When does this really roll off? I mean, when you look at the leases that you have, they were originated in a Conn's or an HHGregg. Is there a particular quarter we should be looking to for where these really are immaterial in terms of the headwind you're up against?

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

Yes. As it stands right now, we've got a small amount left, only about 10%. But the headwinds is the key point, as you mentioned, compared to last year. In the second quarter, with still a lot of revenue in those 2 stores, as I said, we'll improve upon the minus 16%. But the second quarter still had a significant number. Third quarter, not so much. And by the fourth quarter, we're really -- really, it was pretty de minimis. So I think there's 2 more quarters. But it declines the next 2 quarters, but there's really 2 more quarters, the second and third quarter, there will be an impact that's not as big as the first.

Bradley Bingham Thomas - *KeyBanc Capital Markets Inc., Research Division - Director and Equity Research Analyst*

Perfect. And then, Mitch, I was hoping you could just talk a little bit more about some of the management and operational changes that you've made in terms of how ANow works relative to the core. We've been hearing that there's been more of an integration that's gone on. Where does that stand here today? And what gives you the confidence that, that will be favorable, both in terms of the costs that you're pulling out as well as making sure that the operations are still where you want them to be?

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

Well, the couple of significant things in Acceptance Now, from a management standpoint, a lot of the savings there was in the district manager level. Without having the collection centers to manage, the district managers over Acceptance Now, and they're still just over Acceptance Now stores, they can manage more stores because the collections is off their plate, and they're just managing sales now. And the kiosk still do phonecalls at a kiosk, but they're primarily managing sales now. And with the Core taking on the collections, those district managers can manage more stores because their job got -- well, I don't know if it's easier, but their job changed. So they're managing more stores, and that's where a lot of the savings was from a management standpoint. But there's still a whole team of district managers solely focused on Acceptance Now. But with the collections going over to the Core side, we could expand their span of control a bit and leverage a little more. And as I said earlier, I think it's all positive because the district managers can focus on primarily on sales now and people, of course, to get those sales. And the Core taking over the collections activity, the running and picking up of the product, it's certainly something more of the -- more up the alley of the Core stores anyhow. So I think it's all positive from that standpoint.

Bradley Bingham Thomas - *KeyBanc Capital Markets Inc., Research Division - Director and Equity Research Analyst*

Great, great. And if I could just squeeze one more in here on the Core. Obviously, you have done a nice job here of improving same-store sales in the Core. You've had a second quarter in a row here where the gross margin in the Core has been up year-over-year. I guess, could you talk a little bit more here about the trajectory that you're seeing in the business, Mitch? It would look like the way your lease portfolio is evolving that the comps -- it sounds like -- or even better here as we moved into April and should be better in 2Q than 1Q, and that the margins would stay strong as the way you're seeing it. Am I connecting the dots right here, Mitch?

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

I think you are. I think that the -- as you look at the sequential comps continuing to grow and, as I mentioned, at the end of -- where we were at the end of March, with the portfolio being bigger than last year, there's also less free time being used, which directly impacts the comps. And as I mentioned, April just continues that sequential improvement. And this is -- this was without some other things, like the pricing changes that we've made in the first quarter. As you folks know, I brought back Ann Davids, our former CMO, and we're still working on the marketing programs and so forth. We're just starting to even advertise some of the enhancements we've made. So there's more good stuff coming from a traffic standpoint, when you think about the changes we made to the value proposition and actually now advertising them and, obviously, always focusing on improving the execution. But to your original point, Brad, yes, sequentially, it just continues to look better.

Operator

Your next question comes from the line of John Baugh with Stifel.

John Allen Baugh - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Let's start -- there was a comment about initial payment program changing, I think, within ANow. Could you tell me, Mitch, what that change is, what's going on?

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

The initial payment is something we started to test at the end of the quarter. It's lowering the initial payment to align our customers their first payment on their payday versus paying a month. And I think it helps us in a couple of ways. It increases in demand because the initial payment is lower, but it also gets the customer on their next payday when their first monthly payment comes due versus us. The day they are shopping, if they pay a month that day, it might not be their best due date going forward, 30 days from now. So we've got a lower initial payment just to get them to their first payday -- their next payday, and then they could start making their monthly payments. So it increases demand, helps with the collections because it gets the consumer on their right date. And it's, honestly, pretty much the way all of our competition in that space does it. So in a lot of ways, we're just catching up to the competition with that low initial payment.

John Allen Baugh - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Great. And on the ANow collection centers being closed, I guess 2 questions. One, I assume there'd be more product that is not rerouted through Core stores, it's just liquidated in some other fashion. And I'm curious, I assume there was some revenue benefit and maybe margin benefit in the future from rerenting some of those items. So I appreciate that the costs go away. But I'm curious what, if any, offset there is there? And then on the collection side of that decision, you mentioned the stores collect better. Are you putting more resources in the Core stores to collect on ANow?

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

Really, to your first question or point, there's no negative effect because all the product was going back to the Core stores anyhow. I think the company in the past just tested some clearance centers and so forth, but those have been closed last year. So there's product that's all going back to the Core, it goes a little more directly now without the collection centers. The Core has more control over picking it up and putting it in which store that the district manager in the Core business needs it in. So it improves where the product goes, and there's no negative offset to it. As far as the labor in the stores, in a few markets we have to add a little bit of labor, but the returns are so low in Acceptance Now and continue to go down as we shortened the terms on the value proposition, driving a lot more ownership. And the returns are so low, most stores don't need any more labor. There's a few markets where we have to have some labor, and that's -- when I talked about savings of around $25 million a year, a little over $25 million a year, that was net of a little bit of labor we had to add in certain markets before.

John Allen Baugh - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Good. You mentioned you sold 31 stores to refranchise. Can you disclose what you got for those stores? Were they good stores, average stores, bad stores, multiple of rent? Or any color on -- and what that -- how that impacted your P&L sort of going forward? I understand there's cash coming in, but I'm just curious.

Maureen B. Short - *Rent-A-Center, Inc. - Interim CFO*

Yes, John. So the proceeds from the sale of stores in the quarter, as we disclosed in the press release, was $9.5 million. As far as how the stores performed versus the average stores, they were in the third quartile. The way that we look at it is, from a profitability standpoint, we put them in different buckets. And so these were not just underperforming stores that we wanted to get rid of. These are good stores, and every franchise deal is going to be different. We partner with the franchisee to identify markets to franchise. That's our strategy going forward. It's not just, as some have asked about, just a way to unload underperforming stores. We truly believe that franchising is the right strategy for the company going forward and believe that that's the way that we can continue to bring in, to continue growing stores and utilize the proceeds to help improve the balance sheet.

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

And Maureen, the fact those stores being in the third quartile of our stores, the royalty payments on those stores relative to the EBITDA they are making are -- I don't have the exact numbers in front of me, but they're close enough where there's not an EBITDA impact going forward, certainly not a material EBITDA impact going forward, John.

John Allen Baugh - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Okay. And would it be fair to say, though, that the price was less than half of annualized revenue? Or any kind of guide on what the sales the franchisee was on a revenue basis?

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

I'd probably just leave it with the numbers that are in the press release, the roughly [$9.5 million] transaction.

John Allen Baugh - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Okay. And then there was a mention of change or timing of advertising. Could you explain that? And what sort of plan is maybe for '18 versus '17 on the ad spend?

Maureen B. Short - *Rent-A-Center, Inc. - Interim CFO*

Sure. So depending on when the activities take place, in which quarter, that's when we expect -- expense the advertising. And so when we talk about timing differences, it's primarily the year-over-year impact of when the activity occurred. As far as advertising year-over-year, it's about the same as what we have done last year.

John Allen Baugh - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

So that's a quarter 1 comment or that's your plan for the year, '18 versus '17?

Maureen B. Short - *Rent-A-Center, Inc. - Interim CFO*

Full year is fairly similar to last year. As far as the Q1 impact, if you look year-over-year, there was a timing difference, which benefited the quarter this year.

John Allen Baugh - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Okay. And then a couple of last quickies. Where are we, Mitch, with the sort of the virtual decisioning in ANow?

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

Good question. It continues to be a critical piece of what we need to do. There's a lot going on there. We're looking at all of our options to solve that. There are a lot of options on how we could solve that by going out and in-licensing and so forth, and we're continuing to work on that. Hope to have something done in the next 30 days on that. It is a critical piece going forward, but there's an awful lot of white space out there in the Acceptance Now space. And that's going to be our growth vehicle, and we've got some options that we're just trying to finalize over the next 30 days.

John Allen Baugh - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Okay. And last one, quickly. Any change or update in timing of the completion of the strategic review process? I'm sorry I missed it, if you commented on that. And there was some disclosures around bidders versus interested parties and a little nuance there. Any color, anything you can add?

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

No, I'll just let the press release speak for itself. We still anticipate, as the press release says, reaching a determination in the second quarter.

Operator

Your next question comes from the line of Carla Casella with JPMorgan.

Carla Marie Casella Hodulik - *JP Morgan Chase & Co, Research Division - MD and Senior Analyst*

A couple of follow-ups. Did you give the Core stores' skips and stolens rate?

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

Yes, we did. 3.1%, Carla, same as last year in the first quarter.

Carla Marie Casella Hodulik - *JP Morgan Chase & Co, Research Division - MD and Senior Analyst*

Okay, great. And then working capital, you talked a lot about the improvements in working capital. And I'm just wondering, how much of that improvement is coming from inventory reduction and supply chain, or if any of it is coming from the payables side of the business and change in vendor terms?

Maureen B. Short - *Rent-A-Center, Inc. - Interim CFO*

Carla, within the working capital numbers, the majority of the change is coming from rightsizing the inventory. We talked about the $40 million to $45 million we expect to realize in 2018, there's $25 million in onetime benefit from rightsizing the Core inventory, $15 million coming from the onetime benefit of eliminating third-party distribution centers and $6 million in benefits from lower product costs of moving to the direct-to-store model.

Carla Marie Casella Hodulik - *JP Morgan Chase & Co, Research Division - MD and Senior Analyst*

Okay, great. And then on the CapEx side, where do you see it for this year? And then what is the maintenance level of CapEx?

Maureen B. Short - *Rent-A-Center, Inc. - Interim CFO*

Yes, the CapEx that we expect this year is, just as we mentioned last quarter, around $45 million -- I think we said $45 million to $50 million in CapEx -- sorry, $40 million to $50 million for the full year. That is made up of store reimaging, expenses related -- CapEx related to IT costs. So a similar breakout to the past, but we're focused more on reducing CapEx this year to those lower levels. A lot of the decrease is coming from lower technology spend.

Carla Marie Casella Hodulik - *JP Morgan Chase & Co, Research Division - MD and Senior Analyst*

Okay, great. And then just one last one. On the franchise, the reporting for the franchises, the revenue and gross profit and SG&A, it looks -- the percentages, the rates of gross profit next year a little bit strange compared to prior reporting. Is that all just because of the refranchising? And -- or have you changed something in that business on the profitability side?

Maureen B. Short - *Rent-A-Center, Inc. - Interim CFO*

There was an accounting change that's required us to treat the advertising royalties a little bit different than in the past. So you'll see now on the income statement that the amount that we collect from franchisees related to advertising now hits as a revenue item on the income statement as well as a cost item. So there's a net of 0, but now that is reflected here on the franchise income statement versus at being just on the balance sheet previously. This is related to the revenue recognition change that the company adopted in the first quarter of this year.

Carla Marie Casella Hodulik - *JP Morgan Chase & Co, Research Division - MD and Senior Analyst*

Okay, great. So you didn't -- you don't have to restate last year for that, it will just show through each quarter this year?

Maureen B. Short - *Rent-A-Center, Inc. - Interim CFO*

That's correct.

Operator

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

Anthony Chinonye Chukumba - *Loop Capital Markets LLC, Research Division - SVP*

So I just had a question on supply chain in terms of reverting back to the direct-to-store supply chain. I guess if you could just give us a little bit of a history here in terms of why you went with a third-party distribution center network and why you're now, I guess, aside from the working capital change, why you decided to revert back?

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

Well, I think what we analyze is what our cost of goods are running through there. A lot of -- when you have third-party distribution centers, it's related to volume of how much is running through there because you've got a fixed cost, a third-party fixed cost. And as the volume has changed over the last couple of years with store closings and so forth, the cost -- when you add in the cost of redelivering the product from the DCs, you ended up with a higher cost than if we just go buy it direct and go back to what we were doing. So the numbers change over time as far as deflation of electronics and so forth, so the numbers are always moving. And as we look at the current volume level, as I said, in the fixed cost, as with different volume numbers, the fixed cost certainly changes. And everything about our analysis is by going direct to store, augmenting with our national product service centers, as we get the product -- not only get the product to the stores for less money overall, there's a savings there, but then obviously not have it sitting in the DCs from a working capital standpoint.

Anthony Chinonye Chukumba - *Loop Capital Markets LLC, Research Division - SVP*

Okay. And is there any, I guess, incremental labor associated with that change? And also, is there any sort of executional risk in terms of making that change?

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

No, the labor is already there in the national product service centers. In fact, one of the things we talked about in the supply chain is also by rerouting, using some more efficient routing methodology in the service centers that it's actually a $7 million savings there as well. So not only is there not an extra cost of doing it, but by optimizing our routes in the service centers, we're actually lowering our cost there as well. So it's a win-win from a lot of ways, Anthony.

Operator

Your next question comes from the line of Vincent Caintic, Stephens.

Vincent Albert Caintic - *Stephens Inc., Research Division - MD and Senior Specialty Finance Analyst*

First, on the cost savings. So I appreciate you laying out the significant initiatives to improve expenses and very quickly. If you could talk about how these corporate overhead and supply chain redundancies, how these can be cut while keeping the revenues and overall operations of the business unchanged? And I guess, should we be expecting any revenue generations as you go through with more of the initiatives?

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

Well, the revenue is improving as we cut overhead, and I don't think that's necessarily related to cutting the overhead, but it's certainly not impacting us in a negative way from a revenue standpoint. I think that the way the stores operate versus what the way the corporate office operates are 2 different things, and just felt like there's an extra overhead here that we could do without. Sometimes when you have more -- the more overhead you have at the corporate office, the more projects you have going. You're actually impacting the stores in a negative way by giving them more and more projects every month because we're turning out so much work in the corporate office. So I think it actually can help us with less distraction by having less projects going on here at the corporate office. Maureen just mentioned, when Carla asked a question about CapEx, there's a lot less projects, technology projects going on. And less projects, less distraction, less overhead. And it probably helps the stores, if anything, doesn't hurt them.

Vincent Albert Caintic - *Stephens Inc., Research Division - MD and Senior Specialty Finance Analyst*

Okay, great. And secondly, on the pricing actions and the value proposition, if you could talk about the actions on the price inelastic changes in more detail. I know this from checking on the website occasionally. We've seen some of the elastic changes, like the 6 months same as cash. I'm just kind of wondering how the pricing actions will take place for the inelastic products. And any impacts to revenue and earnings that we should see over the course of 2018?

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

Yes. So I think, as you know, Vincent, we got more competitive on the electronic side because that's where there's a lot of price sensitivity between computers and televisions, in making up or margin-wise on the furniture side. And so far, it's been now 5 or 6 weeks, we've seen no negative impact on the "inelastic" products. But furniture side, we haven't seen any less demand there at all. In fact, as I've said, our demand continues to improve.

Vincent Albert Caintic - *Stephens Inc., Research Division - MD and Senior Specialty Finance Analyst*

Okay, great. And the last one I have, and this might be trivial and it was actually touched on a little bit earlier, but I've gotten about a dozen investor questions on this, so I thought I'd ask. So in the past press releases in the strategic review section, you had a discussion about multiple bidders. And this quarter was -- the phrase was changed instead to parties instead of bidders. Just wondering if there's any reason for that or if people are reading too much into that?

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

Well, I don't want to comment any more than what's in the press release. It does sound like from what you're just saying, with all those queries, that people are definitely reading too much into it. But I'll leave it at that.

Operator

Our next question will come from the line of John Rowan with Janney.

John J. Rowan - *Janney Montgomery Scott LLC, Research Division - Director of Specialty Finance*

Just a couple of kind of housekeeping questions. The overall blended, that cost is a little bit higher than I was expecting. Am I assuming -- are we assuming that you're still paying a commitment fee on the revolving facility and that will continue going forward even with a 0 balance?

Maureen B. Short - *Rent-A-Center, Inc. - Interim CFO*

Yes, we do have a fee that we pay on the undrawn balance, which is consistent with what it's been in previous quarters.

John J. Rowan - *Janney Montgomery Scott LLC, Research Division - Director of Specialty Finance*

Okay. And then, obviously, there was a loss per share this quarter. If we were to assume that you guys have a gain at some point for earnings, what would the diluted share count be? I mean, how many shares would we have to add back into that count?

Maureen B. Short - *Rent-A-Center, Inc. - Interim CFO*

It's about 53 million in diluted shares.

John J. Rowan - *Janney Montgomery Scott LLC, Research Division - Director of Specialty Finance*

Okay. And then what's the plan with the cash? Obviously, you're out of your revolving credit facility. You'll continue to generate free cash flow. I know you said you'll build cash, but what are the functions on the notes that you guys can trigger to refinance? What are the important dates, prepayment penalty? Just give me an idea of how else you could go about reducing debt through the notes.

Maureen B. Short - *Rent-A-Center, Inc. - Interim CFO*

Well, John, since we expect the strategic alternatives review process to be completed within the second quarter, I think the way we think about it, rather than building cash since we're not able to pay down the bonds in the existing credit facility, we would make the change and refinance the credit facility. And if we're able to meet the plan and have excess cash, then we would take a look at the capital structure. But as of right now, we're generating over $170 million of free cash flow. And we'll see how the strategic review process, the outcome of that, and then we'll refinance going forward. And we'll look at our overall capital structure and provide more details at that time.

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

Yes, John, the way I think about it is that now the revolver was paid off, the excess cash are just going to help us with the refinancing.

Operator

Our next question is a follow-up from the line of Brad Thomas with KeyBanc Capital Markets.

Bradley Bingham Thomas - *KeyBanc Capital Markets Inc., Research Division - Director and Equity Research Analyst*

I wanted to just ask a high-level question kind of how to think about the year in terms of the puts and takes. Obviously, we're starting with about $71 million of EBITDA from last year. There's clearly, if you have 2/3 of this cost cuts hitting this year, a $60 million tailwind. We can see some of the puts and takes on the trajectory at ANow and the Core. But -- and clearly, a lot of things going right for you. But I just wanted to make sure we're not missing anything in terms of headwinds that you're up against. Obviously, we hear a lot of retailers talk about things like labor prices and transportation prices. I mean, as you guys think of the year, what should we be contemplating in terms of potential headwinds with higher gasoline prices and higher labor prices, for example?

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

There's a little bit of a headwind on our delivery cost with the way we're forecasting the fuel prices, but it's really not all that material, with us having small trucks in the cities and so forth as compared to semis and things like that. So -- and it's pretty immaterial. And the labor side isn't impacting us at this point. We've always paid higher than minimum wages and those kinds of things. So -- and we have a range, depending on the potential of employees, experience and so forth, so we pay within a range. And the more experience they have and so forth, the more they would make anyhow. So that's not changing for us. So I don't -- from a headwind standpoint, Brad, the only one I can think of is the small amount of fuel, Maureen, fuel cost. That's the only one. As we revise our internal financials, that's about the only one that we've talked about going on that's going the wrong direction for us, it's not all -- it's not a game-changer.

Bradley Bingham Thomas - *KeyBanc Capital Markets Inc., Research Division - Director and Equity Research Analyst*

Great. And then, again, it clearly feels like things are moving in the right direction from our top line perspective. I guess, circling back to these cost cuts, we've seen cuts under executives when you were not with the company, where there some missteps after those cuts or initiatives. And I guess, the question would be, what are you monitoring most closely to make sure that these cuts don't impact the business?

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

Well, we look at our metrics daily. Actually, you have your reports throughout the day. But delivery impact in the stores, collection impact, revenue collection and so forth, so we monitor our store metrics and our Acceptance Now metrics at least on a daily basis. And a lot of VPs are looking -- can fill up their numbers every couple hours and see how the stores are trending for the day, especially if there's an event going on, we have some big sales contest going on or something like that. So just the everyday metrics of renting and collecting, and so far, so good, Brad.

Operator

At this time, I'll turn the conference back over to Mr. Fadel for any further remarks.

Mitchell E. Fadel - *Rent-A-Center, Inc. - CEO & Director*

Thank you, Regina, and thank you, everyone, for joining us. Appreciate your time, appreciate your support. Glad to update you on our turnaround program here, and look forward to updating you again next quarter as we see things only continuing to get better. So we appreciate your time and wish you a great day.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you all for joining and you may now disconnect.
