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- Mitchell Fadel; Upbound Group, Inc.; Chief Executive Officer
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Participants:

- Robert Griffin; Raymond James; Director, Equity Research
- Robert Griffin; Raymond James; Director, Equity Research
- Jason Haas; Bank of America; Analyst
- Vincent Caintic; Stephens; Managing Director
- Kyle Joseph; Jefferies; Analyst
- John Rowan; Janney Montgomery Scott; Director
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PRESENTATION

Operator^ Good day. And thank you for standing by. Welcome to the Quarter Three 2023 Upbound Group Incorporated Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. I would like to now hand the conference over to your first speaker today, Brendan Metrano.

Brendan Metrano^ Good morning. And thank you all for joining us to discuss the company's results for the third quarter of 2023. We issued our earnings release before the market opened today. And the release and all related materials, including a link to the live webcast are available on our website at investor.upbound.com. On the call today from UpboundGroup, we have Mitch Fadel, our CEO; and Fahmi Karam, our CFO.

As a reminder, some of the statements provided on this call are forward-looking and are subject to factors that could cause actual results to different materially from our expectations. These factors are described in our earnings release as well as in the company's SEC filings.

Upbound Group undertakes no obligation to publicly update or revise any forward-looking statements except as required by law. This call will also include references to non-GAAP financial measures, and our discussion of comparable performance will generally refer to non-GAAP results.

Please refer to our third quarter earnings release, which can be found on our website for a description of the non-GAAP financial measures and reconciliations to the most comparable GAAP financial measures. With that, I will turn the call over to Mitch.

Mitchell Fadel^ Thank you, Brendan. And welcome everyone, to the call this morning. We are pleased to report another strong quarter for the company, which generated financial results at the high end of our financial outlook. Non-GAAP diluted earnings per share was $0.79 compared to guidance of $0.70 to $0.80 and revenues of $979 million and adjusted EBITDA of $106 million.

We are encouraged to see our businesses are on track to meet key operating objectives for the year despite the continuing challenging external conditions. We again delivered sequential improvement in top line trends, lower overall loss rates year-over-year and strong margins due to stable customer payment behavior in the third quarter.

Considering the third quarter strong financial results, the positive trends we're seeing in the business and the resilient underlying fundamentals of the leased-owned model, our outlook for 2023 has continued to improve. Accordingly, we increased the midpoint of our 2023 financial targets, which Fahmi will discuss in more detail in a few minutes.

Before reviewing our third quarter results, given ongoing headwinds across consumer credit, I think it's worthwhile to offer some perspective on the state of the non-prime consumer who we believe we know well based on Rent-A-Center's 50 years of operating history in this market. The fact that we've been successful for over 50 years speaks to the durability of the leased-owned model and its relative stability within disruptive economic environments.

We attribute this countercyclical aspect to a few factors. First, our lease solutions have a strong value position for consumers with credit and liquidity constraints, who otherwise may not be able to access important durable goods like furniture and appliances and tires and big-ticket electronics. So it's not surprising that they will often reprioritize budgets to stay on lease with us as long as possible, especially given the important role these products play in their lives and the flexibility of the lease, which allows them to return the products free of any obligation.

Second, historically, some non-traditional LTL consumers will trade down from credit solutions when lending conditions tighten and they no longer qualify for traditional consumer financing.

This trade down can help sustain our lease portfolio, drive incremental lease portfolio value and help manage credit risk with higher credit quality consumers entering the top of the funnel. We've seen signs of trade down in our applicants and portfolios over the past 3 quarters and we believe this dynamic could be a positive tailwind of our results if a slowdown in the economy continues.

Regarding the current state of our consumers, many households are experiencing financial pressures due to higher prices for non-discretionary items, growing debt balances and high interest rates, limited wage growth and decreasing bank account balances. Well, these dynamics are causing certain customers to remain on rent for longer. It's important to recognize that many of our customers -- that many of the customers we serve are accustomed to living on tight budgets and are adaptable to changes in financial position.

In addition, the labor market for wage workers remains relatively tight, providing ample opportunity to find employment and our underserved consumers have been under this inflationary pressure since mid-2022. And although the environment has not improved, it has stabilized as consumers have adjusted their cash priorities and we've adjusted our operations to balance meeting their needs and generating appropriate risk adjusted returns.

Our underwriting and account management have continued to evolve over the past, year improving the quality of our lease portfolios.

So what we've seen some recent softening in the financial profiles of customers and applicants, we do not expect it to translate to a significant increase in delinquency and loss rates in the foreseeable future. In fact, given the better-than-expected yields in the Acima business, we've been able to tactically underwrite leases in certain channels that the best credits tends to pick up GMV buying volume with just a modest uptick in delinquencies and loss rates.

The more challenging aspect actually of consumer behavior for us today is the ongoing impact of demand pulled forward in key durable good categories, especially for Acima's furniture-oriented merchant partners. On a positive note, we have partially offset the soft demand by expanding our presence in less penetrated categories such as auto and jewelry. Today we have a more diverse product portfolio that should be even better positioned for growth when the effects of the demand pull forward dissipate.

So looking at 2024, we will be almost three years out from peak stimulus and we expect furniture demand should begin to normalize. Putting the pieces together, we believe the non-prime consumer has been and will continue to be resilient and is in relatively good shape for this environment, which further increases our confidence that the company can return to growth in 2024. Now moving to third quarter results.

The Rent-A-Center segment performed in line with our expectations. Revenues and same-store sales decreased approximately 4% year-over-year, improving from a 4.9% decrease in the second quarter with both rental and fee revenue and merchandise sales revenue down year-over-year. However, despite ongoing top line pressures, numerous forward-looking KPIs demonstrated promising sequential improvement relative to the first half of 2023.

The portfolio value finished the quarter two.7% lower year-over-year, the best performance year-to-date and almost 18.5% above the third quarter of 2019 on a per store basis. Deliveries for the quarter were down a modest 2% year-over-year despite continued pressure on consumer durable good spending we see more broadly, which reflects the team's strong execution and the resilient underlying demand for Rent-A-Center's leasing solutions.

We continue to make progress on strategic initiatives in the third quarter, including logistics enhancements to improve the omnichannel experience.

Our 50th anniversary campaign that drove a 40% lift in web traffic and a 15% lift in web orders for the quarter. We've relaunched our presence in tires when we opened 4 new stores. Higher Rent-A-Center web traffic led to an increase in e-commerce revenue, which accounted for approximately 25% of the third quarter revenues compared to 23% in the prior year period.

Extended aisle continued to generate strong growth with deliveries up 129% year-over-year. As we continue to add to our product lineup, which by the way, we now offer about 12,000 SKUs on rentacenter.com, which is over 50% more year-over-year as far as the SKUs online. The emphasis we've placed on risk management over the past year continued to pay off as well in the third quarter with loss rates and delinquency rates in line with our expectations.

Skip/stolen loss rate for the third quarter of 4.3% was down 20 basis points sequentially and down 150 basis points year-over-year with a 30-day pass due rate of 3.1%, decreased 40 basis points year-over-year and is stabilized during a seasonably tough quarter.

Moving on to Acima, top line trends continued to improve there as well in the third quarter as we expected. GMV decreased 1.4% year-over-year, improving 440 basis points relative to the second quarter.

And we saw modest growth in key metrics like active merchant locations, applications, funded leases, and open leases. The external backdrop remain challenging with traffic and volumes for many merchants in more established categories like furniture and home electronics and appliances still negatively impacted by that demand pull forward and the ongoing pressure on consumer budgets.

The team has done a great job expanding the platform in less established product categories. Like I mentioned before, things like auto and jewelry and channels like e-commerce in the Acima marketplace have really helped us offset sluggish demand.

In addition, we picked up some good regional account wins and enhanced commercial positions with a few key merchants that also contributed incremental lease volumes in the third quarter.

And based on conversations with current and prospective merchant partners, we believe that Acima is gaining both mind share and market share in the industry. Our e-comm capabilities, our ability to staff high volume stores and our flexible lease terms are key differentiators for us.

Positive trends in September have carried over into October, increasing our confidence that GMV should grow in the low single digits year-over-year in the fourth quarter as we've been predicting all year, which positions us well to end the year with a strong portfolio and grow revenue and profits in 2024. In fact, September was the first month of positive year-over-year GMV growth since December of 2021 and October was positive as well.

Margins were strong again in the third quarter with adjusted EBITDA margins at Acima of 15.3%, up 270 basis points year-over-year, benefiting from stable loss rates and a lower mix of customers electing the earliest lease payout option, which increases our yield. After three quarters of consistent declines in earliest payouts, we feel confident that the mix is stabilized back to pre-pandemic levels that are several 100 basis points below 2021 and 2022.

Although we have seen a very modest uptick in delinquencies and loss rates in the third quarter, we do not believe it's directly attributable to customers shifting from early payouts to staying on lease. Rather, it is related to seasonality, a slight shift in mix to e-comm and isolated certain pockets of risk in our legacy acceptance in our business, which we have addressed by taking further underwriting actions in the quarter.

The effective slightly higher loss rates has been more than offset by the higher yields and margins we're earning for more customers staying on lease longer. We continue to advance initiatives that should enhance the company's competitive position and growth opportunities. The product development team launched several improvements that continues to reduce friction for merchant partners and makes Acima's offerings relatively easier to integrate and transact with versus our competitors. This dynamic is especially true for e-commerce retailers.

Additionally, our partnership with Concora Credit, which was formerly known as Genesis Financial Solutions, is progressing nicely and we've gained important insights through early testing.

Looking forward to the final months of the year, we think that our business should be approaching a normalized base from which we can start to progress on our 3-year financial targets we outlined at our Investor Day earlier this year, which we believe can sum up to a high-teens to low 20% annual total shareholder return.

Now moving to Slide Five in an overview of our key priorities for the year. For the Rent-A-Center segment, we are focused on enhancing our omnichannel platform and performance by expanding our extended aisle offerings and continue to improve and grow the e-commerce customer experience.

And additionally, logistics initiatives to improve our last mile capabilities, which are a differentiating factor for us. Additionally, our plans to enhance underwriting at Rent-A-Center by leveraging aspects of Acima's decision engine that should help us accrue more of the right Rent-A-Center customers.

For Acima, our top priority is to increase lease applications and manage risk to start 2024 with a strong portfolio. Key initiatives supporting those objectives, including Acima marketplace, a robust business development pipeline, and further enhancing data analytics and underwriting.

Next, we remain focused on enhancing Acima's market position as the most effective LTL solution for merchants by making Acima even easier to integrate with, continuing to reduce friction points for e-commerce and partnering with financial solution providers to create more holistic offerings.

Top priorities at the Upbound holding company level are implementing our partnership with Concora Credit, realizing synergies between the operating segments and investing in our technology organization to support our growth agenda as we head into 2024.

Looking back over the last 10 months, I'm really impressed with the company's progress. Despite the external headwinds, we've made numerous changes and upgrades and processes, people and technology to create what I believe is a best-in-class platform for non-prime financial solutions serving consumers and merchants.

It's exciting to see the pieces coming together and the potential additional value we can create for our customers, our partners, and our shareholders and I want to thank the entire team for their tremendous efforts and dedication. And with that, I'll turn the call over to Fahmi.

Fahmi Karam^ Thank you, Mitch, and good morning everyone. I'll start today with the review of the third quarter results and then discuss our updated fiscal year 2023 guidance, after which we will take questions. Beginning on Page Six of the presentation. Consolidated revenue for the third quarter was down 4.4% year-over-year with Acima down 5.8% and Rent-A-Center down 4.2%. Rentals and fees revenues were down 2.7%, reflecting lower portfolio values for both businesses during the third quarter of this year.

Merchandise sales revenues decreased 13.6% due to fewer customers electing earlier payout options. The dollar decrease in revenue was fairly evenly split between rentals and fees revenue and merchandise sales revenue. Consolidated gross margin was 50.8% and increased 140 basis points year-over-year with improvement in the Acima segment partially offset by lower margins in the Rent-A-Center segment.

Consolidated operating expenses, excluding skip/stolen losses and depreciation and amortization were up low single digits with a low single digit decrease in store labor and other store expenses more than offset by higher general and administrative costs as a result of certain corporate investments and incentive-based compensation tied to company performance. Ongoing enhancements to underwriting and account management drove a 50 basis point year-over-year reduction and consolidated skip/stolen loss rate to 7%.

On a sequential basis, consolidated loss rate increased 10 basis points due to seasonality and a modest uptick in the Acima segment, notably the legacy Acceptance Now business. Putting the pieces together, consolidated adjusted EBITDA of $106 million decreased 7.8% year-over-year on lower Rent-A-Center segment EBITDA and higher corporate costs partially offset by higher Acima segment EBITDA.

Adjusted EBITDA margin of 10.8% was down approximately 40 basis points compared to the prior year period with approximately 270 basis points of margin expansion for Acima more than offset by approximately 120 basis points of contraction for Rent-A-Center and 120 basis point increase in corporate costs as a percent of sales. I'll provide more detail on the segment results in a moment.

Looking below the line, the third quarter net interest expense was $27 million compared to $23 million in the prior year due to approximately 300 basis points of year-over-year increase in variable benchmark rates that affected our variable rate debt, which was approximately $815 million at quarter end. The effective tax rate on a non-GAAP basis was 25.5% compared to 26% for the prior year period. The diluted average share count was $56.9 million in the quarter. GAAP earnings per share was $0.08 in the third quarter compared to a loss per share of $0.10 in the prior year period.

After adjusting for special items that we believe do not reflect the underlying performance of our business, non-GAAP diluted EPS was $0.79 in the third quarter of 2023 compared to $0.94 cents in the prior year period.

During the third quarter, we generated $63 million of free cash flow compared to $106 million in the prior year period, and we distributed a quarterly dividend of $0.34 per share. We repurchased approximately 900,000 shares in the third quarter, and we finished the quarter with a net leverage ratio of approximately 2.5x, unchanged from the second quarter.

Drilling down to the segment results starting on Page Seven. Rent-A-Center (technical difficulty) prior year period. Total segment revenues decreased 4.2% year-over-year in line with our expectations and improved from a 4.9% decrease in second quarter. Same-store sales decreased 4% year-over-year in the third quarter compared to a 4.9% decrease in the second quarter.

Skip/stolen losses continue to improve driven by ongoing underwriting efforts, decreasing 150 basis points year-over-year to 4.3% and 20 basis points sequentially.

Past due rates also decreased year-over-year with 30-day past due rates averaging 3.1% for the third quarter compared to 3.5% for the prior year period. Adjusted EBITDA margin for the third quarter decreased 120 basis points year-over-year to 15%, primarily due to de-leveraging effect of lower revenues on fixed costs. This is reflected by 195 basis point year-over-year increase in the ratio of operating expenses, excluding skip/stolen losses as a percent of revenue, even though expense dollars decreased year-over-year.

Adjusted EBITDA margin decreased 290 basis points from the second quarter, primarily reflecting normal seasonality and higher marketing expenses. For Acima, as we expected, GMV year-over-year trends continue to improve sequentially in the third quarter, approaching positive territory. Moreover, we experienced year-over-year growth and some key underlying drivers with active merchant locations and applications up low single digits.

Those tailwinds were offset by lower average ticket size and lower approval rates as e-comm and direct-to-consumer become a bigger portion of the application mix.

Looking at the portfolio, open lease count was up mid-single digits both year-over-year and sequentially, and was the highest level since the first quarter of 2022. Revenues decreased 5.8% year-over-year, including a 3.2% decrease for rentals and fees revenue. Merchandise sales revenues decreased 14.5% year-over-year due to fewer customers electing the earliest payout option with the mix of those transactions for the third quarter dropping down to levels last experienced in 2019. Skip/stolen losses were generally in line with our expectations for the third quarter.

The virtual business losses as a percent of sales were 7.8%, a 10 basis points higher sequentially, and within our long-term target range of 6% to 8% while losses at the legacy Acceptance Now business were in the double digits. During the quarter, we observed softening of performance at A Now and tightened underwriting.

We have begun transitioning merchant partners from the A Now underwriting decision engine to the Acima platform, and we'll continue with the larger accounts through the fourth quarter and the first part of next year.

This will improve our underwriting capabilities and we should reduce losses as the back book from the legacy system winds down. On a consolidated basis, the loss rate of 9.4%, which was consistent with our third quarter outlook. Operating costs excluding skip/stolen losses were down mid-single digits in the third quarter with lower labor costs from reduced operational headcount, largely offset by increased marketing investments.

Operating costs excluding skip/stolen losses as a percent of sales increased 20 basis points year-over-year due to the de-leveraging effect of lower revenues. Adjusted EBITDA of $72.8 million was up 14.5% year-over-year, primarily due to a 10% decrease in cost of goods sold, driven by fewer early payout transactions that was partially offset by lower revenues.

Adjusted EBITDA margin at 15.3%, increased approximately 270 basis points year-over-year, driven by 330 basis points of gross margin expansion. For the Mexico segment, adjusted EBITDA was higher year-over-year and the franchise segment adjusted EBITDA was lower. Corporate costs were approximately 25% higher compared to the prior year, primarily due to higher projected performance-based compensation.

Shifting to the 2023 financial outlook, note that references to growth or decreases generally referred to year-over-year changes unless otherwise stated. Most of my commentary will be focused on the non-GAAP results. Our forecast assumes a macroeconomic backdrop consistent with existing conditions, continued discipline and targeted underwriting, and a slight increase in unemployment. We did not incorporate any material benefit from trade down or the credit card loan partnership.

For the full year, we expect to generate revenue of $3.95 billion to $4 billion. Adjusted EBITDA is now expected to be $450 million to $460 million, excluding stock-based compensation of approximately $25 million.

We are raising the lower end and the midpoint of our target range for fully diluted non-GAAP earnings per share to $3.45 to $3.55, which assumes a fully diluted average share account of $56.3 million and no further share repurchases through the remainder of the year. We expect $215 million to $235 million of free cash flow, which is somewhat lower than the previous outlook due to higher projected GMV for Acima and replenishing our inventory for the Rent-A-Center business.

As you may recall, GMV growth and portfolio growth tend to reduce free cash flow conversion as the cash outflow for product is greater than the associated lease payments collected in the near term. We expect net interest expense of approximately $110 million and a non-GAAP effective tax rate of approximately 26%.

My discussion on the outlook for operating segments will focus on the fourth quarter. For the Rent-A-Center segment, we expect portfolio value will finish the fourth quarter flat to down low single digits.

We expect revenues will also be flat to down low single digits and adjusted EBITDA margin to be in the mid-teens. Loss rates should be relatively similar to the third quarter in the 4% to 4.5% range. For Acima, we expect fourth quarter GMV will be up low single digits year-over-year with revenues up low to mid-single digits. We expect gross margins will be similar to the third quarter and do not anticipate additional decreases in the mix of consumers electing the earliest payout option.

We expect adjusted EBITDA margin will be in the low to mid-teens with stable gross margins, partially offset by higher loss rates due to a seasonal uptick in the fourth quarter and higher losses in the legacy A Now business.

For Mexico and the franchising businesses, we expect Mexico revenue will be up mid-teens year-over-year and franchise revenue down low double digits. We expect both Mexico and franchise adjusted EBITDA to be up year-over-year and sequentially. Corporate costs are expected to increase mid-single digits sequentially.

Regarding capital allocation, we repurchased 900,000 shares during the third quarter, and then another 800,000 shares in October, totaling $50 million and 3% of basic shares outstanding. We opportunistically elected to return capital to shareholders, given what we believe is a favorable return offered by our shares at recent price levels. Our strong cash flow generation and liquidity allows to take a balanced approach to capital allocation, which we have achieved year-to-date.

The company has paid down approximately $135 million of debt and returned $88 million to shareholders through dividends and share buybacks through the end of the third quarter.

Looking out over the next couple of quarters, our top priorities will likely be more aligned with our long-term priorities of reinvesting in the business, dividend payments, and debt reduction. We ended the third quarter with $1.3 billion of outstanding debt and net leverage of 2.5x. We are still targeting leverage of 1.5x over the long term, but we will continue to assess market conditions and reasonable alternative uses of capital that generate favorable risk adjusted returns for shareholders.

To conclude, our business fundamentals remain strong. We are encouraged by the strong top line trend in our progress to returning growth in both of our major segments. While there are still a high level of external uncertainty and headwind on consumer durable goods spending, we remain confident in our ability to balance GMV growth, supporting our consumers and merchants' needs while appropriately managing risk.

We're focused on disciplined underwriting and expense management, while also investing in capabilities that will drive sustainable long-term growth for our shareholders. Thank you for your time this morning. We will now turn the call over to your questions.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) Our first question today comes from the line of Bobby Griffin with Raymond James.

Robert Griffin^ I guess, congrats on some of the inflection points here on GMV with Acima and some of the success that it's starting to show up. I guess my first question is just a little bit more kind of multi-year or just higher level. We've always been trained to look at the trailing portfolio balances in these businesses to help guide us to next year or the future revenue and things like that.

And I know we don't want to give 2024 guidance, but with this earning season, we've seen some more cautious commentary about 2024. So just when you guys sit here today and help us tune up our models, how do you think the portfolio balances in both of your key segments set 2024 up?

And my second question, I'll just go ahead and ask now, has the dynamic around 90-day buyouts been an over-earning aspect this year, or has it just been more of things normalizing where we don't need to be overly concerned that we have to make a counter adjustment next year?

Mitchell Fadel^ I'll start and then Fahmi can add in. As far as the portfolio, yes, we don't want to get into 2024 right now, but the comments we did make, like if you look at the two segments, we're going to starting with Acima be positive GMV for the first time.

Well, as we said, September and October positive GMV for the first time in a couple of years. And as we think about the fourth quarter being positive, we roll into 2024 with momentum from a GMV standpoint growth wise, we wouldn't expect that to start going the other way at the beginning of 2024. And then Rent-A-Center, we said the portfolio, it's made progress all year.

It's best level in a couple of years now where it's only down 2.7% compared to last year, which was a 200 basis point improvement. If we're not flat, we're going to be real close to flat at the end of the quarter, we sit flat to down low single digits for the portfolio.

So you think about that, that momentum in the Rent-A-Center business and that being a flat portfolio or even if it's a whatever low single digits, say minus 1% or something very small going into the next year with momentum. So I think both segments have the positive momentum that we've had all year in reducing the negative numbers that it is turning positive in the Acima in the fourth quarter. We believe it'll turn positive Acima in the fourth quarter as evidence in September and October and then Rent-A-Center being real close to flatten portfolio going into next year. So some positive momentum in both of them.

And then the second part of your question on the 90-day, the earliest payout options on the Acima side or even the Rent-A-Center side, but I think you're particularly talking about the Acima side, we're back to pre-pandemic levels. So we think this is normal. It's not a new normal, it's actually just back to the normal from the elevated levels of the stimulus drove in 2020 and 2021. So I don't think you have to factor in anything different because they're just back to pre-pandemic levels.

Fahmi Karam^ Yes, Mitch, I definitely agree with the commentary around 2024. I do think we'll end the year on a really strong note from a portfolio standpoint on both of the businesses. We will have some tough comps on Acima side going into next year from a margin standpoint.

We are reaching 16%, 17% EBITDA margins in the second quarter was something we've said is probably not sustainable at those levels, but very happy with where we are from a GMV standpoint as it trended up really throughout the quarter. And as we commented showing growth in October as well. So from a 2024 standpoint, still feel like we'll be able to grow both revenue and EBITDA at both segments.

Robert Griffin^ And it's for Fahmi, is that partly a function usually flattish to maybe even slightly up portfolio, you'd have some OpEx expense that could hurt or kind of hinder a little of the growth. Is the confidence in the growth just partly a function that you've been able to scale the organization's cost structure to be able to flow through EBITDA growth on a more flattish portfolio to start the year?

Fahmi Karam^ Yes. I think we'll definitely be more efficient as we find synergies between the two segments I do think though we are prioritizing putting investment back into the business to make it more consumer and merchant-friendly. So, we will spend money where it's appropriate to support the growth. But generally speaking, we're very focused on making the operations more efficient. And you'll see that with Acima as we continue to grow revenues, you'll see some of that operating leverage really play out just given the virtual nature of the business.

Brendan Metrano^ And I think the other one to add to that, when you think about margins is the losses on the Rent-A-Center side have come down all year. So early in the year, we'll have some positive loss comparisons on the Rent-A-Center side from where they were earlier in the year as they've inched their way down.

And then on the Acima side, even though they've been in line all year on the virtual business, as we convert the legacy Acceptance Now business, the Fahmi was talking about as prepared comments as we convert that, then we have some tailwind from a comp standpoint on losses on the Acima business relative to the legacy business.

Operator^ Our next question comes from Brad Thomas with Key Bank Capital Markets.

Bradley Thomas^ A couple questions if I could, first wanted to start just with the GMV outlook on the Acima side, and was wondering if you could just give us a little bit more color on some of the growth drivers here in the composition, just as we think about the trend in the number of doors and partners you have, what's going on with the average customer balance for new leases number of items that that are being rented and any color on kind of the product segments or channels? Just again, a little more color on how things are evolving there maybe to start.

Mitchell Fadel^ Primarily the growth, the improvement in GMV on the Acima side has been -- there's three or four reasons for it. Growing merchants that's probably number one and more coming out of our marketplace and Acima.com is another one. And sometimes it's not just growing merchants, but as we mentioned, enhancing our position with merchants. There may have a couple of different lease stones in their store, but if you prove to be their best option and get in a number one position versus a number two position that helps. And then the diversity of categories as furniture continues to struggle year-over-year per door, we're making nice inroads in the wheel and tire business and the auto space.

That's been a lot of the merchant growth as well. And those aren't down year-over-year. Those are actually up year-over-year when you think about door productivity. Same with jewelry. We're adding merchants plus the door productivity per store is not down like it is in furniture.

So all those things are making up for retail furniture on a per door basis being down for us. But growing merchants diversifying the categories, enhanced positions with some merchants and then the marketplace, the direct to the consumer stuff is working really well too.

Brendan Metrano^ Yes, if could just add on to that a little bit as far as the GMV trajectory, really saw inside the quarter growth from July and August into September, and I think we've mentioned it on our prepared remarks around September being the first month of year-over-year growth since December of 2021 on the Acima side.

So really strong performance for everything that Mitch said applications were up, our conversion rates were up slightly year-over-year. Average ticket size has come down, which was a little bit of a headwind to GMV, but Q1 or Q2 was better than Q1, Q3 was better than Q2 and Q4 should be better than Q3. So a lot of momentum around GMV and its gross prospects.

Fahmi Karam^ Which I think just adding on one more thing to that, Brad, if you think about the furniture pull forward being probably the biggest headwind that we have in household durable goods a little bit in appliances and electronics, but it's primarily furniture with all that pull forward from the stimulus money in 2020 and 2021, that as things normalize and I don't think they're going to normalize in the next 90 days or anything like that when it comes to that furniture pull forward.

But if you think about adding the merchants that we're adding, doing more on our marketplace, we mentioned in our prepared comments some good regional wins. We don't have a national one that to talk about just yet, but we've some good regional wins take which basically means taking share from our competition. And when you add all that together and then furniture does improve, presuming 2024, maybe it's not normal, but 2024 is better than 2023.

And I think when we talk to our furniture partners, 2025 will be better than '24 and probably '26 will be better than '25, and maybe you level off, then it's going to take another couple of years. But if we're already positive for other reasons from a growth standpoint, we're in really great position for when the furniture per door productivity comes back.

Robert Griffin^ We would agree. Certainly all the data we have is that furniture's trending at below normal trends in the United States right now. So a reason for optimism longer term. On the Rent-A-Center side, Mitch, just as we look at some of your competitors, I mean, it does look like your results have been well lower year-over-year significantly better than competitors. Can you maybe talk about what you're doing to maybe take share and maybe how the weekly value proposition may be more compelling if it is in this current environment than what some of your competitors offer?

Mitchell Fadel^ Yes. I think Rent-A-Center has performed pretty well improve the negative theme to our sales each quarter. And as we mentioned deliveries year-over-year being only 2% off if you compare them to traditional retail and half of the Rent-A-Center business is furniture too. So only being 2% off, we feel pretty good about and that improved as the quarter went on as well as July, August and September. So yes, I think we're just sticking with you are focusing on execution. The e-commerce, as I mentioned has been really strong.

We continue to grow it. When you think about e-commerce, 25% this year, roughly, versus 23 last year growing when and then '22 was better than '21 and so forth.

So even post-pandemic, continuing to grow the e-commerce with the extended aisle stuff that's on there as I mentioned, and just really focusing on execution, we haven't changed our model. We're still in the communities with all of our stores, a steady store count, not moving them all over the place and doing things like that. We're just steadily focusing on the customer, being there for them in a traditional way, expanding the offerings form certainly, but really focus on execution and sticking with our core model.

Operator^ Our next question comes from Jason Haas with Bank of America.

Jason Haas^ I'm curious if you think you're seeing more trade down now than you were earlier in the year. And I know it's hard to guess, but do you expect to see more trade down going forward?

Mitchell Fadel^ It is hard. It is hard to say. We can look at vantage scores and stuff like that and see a little bit of it, but that's not the only indicator, right? When you think about trade down, we de definitely think it is part of what's happening. Don't know that it is -- yes, I think I'd say it's been pretty modest.

All the data we're looking at, we think we could get more in 2024 as credit tightens and it's possible that it goes up from here. We don't have that forecasted or anything. It would be a positive tailwind and upside, but it's been pretty modest. But I think it's definitely there. I can't say, Jason, that there's more today than there was 30 days ago, 60 days ago, 90 days ago or even earlier in the year.

It's just really hard to say. But on the other hand, when you think about what I was just mentioning to Brad, when deliveries at Rent-A-Center are down 2% year-over-year, and half their business is furniture. And when you look at, we talked to our big furniture partners that we have on the Acima side and even suppliers big names like Ashley Furniture and so forth. I mean, it's down a lot more than that, right? Furniture.

So is that because of trade down? It's got to be part of it. The team's executing really well, but they probably need a little help besides execution. And I think there's probably some trade down in there. Maybe it's more than we think. It is just really, really hard to say.

There's definitely some there and it could accelerate as we go forward. I don't know if anybody wants to hear it, but if unemployment goes up a little bit, it probably even accelerates. If unemployment gets worse in the country in 2024, it may even accelerate if there's even more tightening above us.

Jason Haas^ And then how about the impact from student loans? I know we're pretty early into that, but I'm curious if you've started to see any discernible impact from those on loss rates or anything in the business that seems to be related to those repayments starting?

Mitchell Fadel^ No, we haven't. We've been watching it and looking at it, trying to see if there's any differences. Same thing we get asked the question sometimes about the Snap program and so forth, but nothing discernible that we can tell at this point.

Fahmi Karam^ Yes one of the things that we have started to notice a little bit and again, very early on but on the frontend folks that have student loans have started to convert a little bit less now than where they were kind of before the it turned back on. So nothing in our lawsuit, nothing in our delinquencies, but we have seen some of it come in from the frontend on the underwriting side.

Operator^ Our next question comes from Vincent Caintic of Stephens.

Vincent Caintic^ First one on the components of GMV. So nice to see the sequential improvement in that. And I'm just wondering if you could talk about the components in terms of underlying demand. It sounds like maybe that stabilized is starting to improve but then you talked about tighter underwriting. So maybe that dynamic slows it down a bit, but if you could talk about that.

And then on Acima specifically nice to hear the guide for positive GMV in the fourth quarter. Just wondering when I compare that to Rent-A-Center, if that growth in Acima is from same-store sales differences, or if, because you're adding more merchants that you're able to offset maybe what might be similar same-store-sales performance between Acima and Rent-A-Center?

Mitchell Fadel^ Sure. Vincent, let me start and then Fahmi can weigh in. I'll take the last part of that first. Yes. I think that is the difference where Acima has growth in merchants, growth in the marketplace and Rent-A-Center does two on rentacenter.com, but more growth in the marketplace and just growing the merchants and growth, when you think about it from a same-store-sales standpoint, it's probably positive and we don't really look at that way, but just knowing the numbers, I do look at the verticals like auto, the wheel and tire verticals probably on the same-store basis are flat to positive.

Of course, furniture's down, like we're talking about appliances probably down a little bit as well but I think from a same-store-sales standpoint, it would.

From Acima, it would depend on the vertical. Some would be positive and some wouldn't be like furniture as I mentioned. But the growth is really -- the difference between Acima and Rent-A-Center is we're adding merchants everyday really. On the Acima front, I mentioned a few good regional winds where it's adding some GMV and taking market share.

I think Rent-A-Center's probably taking a little market share too when you compare the numbers, but I think Acima adding merchants every day is probably why they'll hit positive. They're hitting positive first, even though you see the improvement in both segments, they'll hit a positive inflection point first, even with the tighter underwriting.

And as we mentioned, Vincent, and as you know, when it comes to underwriting, when you say tighter overall, I'd agree with that. I would say we're tighter today than were yesterday overall.

On the other hand, we do look for pockets performing partners and performing risk bins that you can dig deeper in and take more risk in. So it's not like a carte blanche, just tighten everything certain people, certain scores, the certain people, what they look like when they come into the decision engine, depending on their scores and other attributes, we dig deeper when we can, so that helps too.

Fahmi Karam^ Yes. Vincent, I think the Mitch's answer for the second part of your question, it really applies to the first part as well, just from a standpoint of demand per location is probably down, but given we're adding more locations, that's why I mentioned the applications were up year-over-year. And then as far as the tightening that we mentioned in the prepared remarks, we really isolated it to our legacy Acceptance Now business, you've heard us talk a lot about synergies between the two major segments.

And I think one of the biggest components of that is on the underwriting side and making sure that our underwriting capabilities at Acima, we apply on different parts of the business and the legacy Acceptance Now business rolls into the Acima segment but they are on two different underwriting systems today.

We've started converting them earlier this quarter and we'll continue to do that throughout this year and the first part of next year to get the underwriting platforms consistent on the Acima consolidated business segment. And we did have to tighten there.

And so you've seen that impact in our loss rates this quarter, a little bit, 40 basis points up year-over-year. You'll see that again in the fourth quarter as you cut revenue before you start seeing the impact on the loss dollars but as soon as that gets converted over, I think you'll start seeing a trend much more in line with the Acima segment and Acima virtual business.

Mitchell Fadel^ Yes, and that's a tailwind in the next year. Anything about the virtual business being between six and eight and we've been more like nine. If you look over the last four quarters, 9 and 9.5 because of the legacy business adding into that. So once that legacy business runs through there, certainly the latter half of next year at least, and then you're at six to eight, that's a nice tailwind for next year.

Operator^ Our next question comes from the line of Kyle Joseph with Jefferies.

Kyle Joseph^ Thanks for taking my questions. Most of them have been answered, but on Genesis or sorry, Concora, just remind us timing in terms of when you anticipate that needing to flow through our models and how exactly that's going to flow through the P&L and which segment it flows through and how it impacts and when it should start impacting the consolidated P&L?

Mitchell Fadel^ Yes. We're really excited about the prospects of the partnership. We're still in test mode and rolling it out in a few stores, but really positive discussions with our both our small and medium-sized businesses as well as our bigger regional players. So the ones that don't have a second look provider are excited about having a second look provider at their locations for their customers. And the ones that do today really like the benefit of having one vendor that has two products. And so really excited about the prospects of it.

We'll look to roll out really in scale beginning of the year in 2024 on both the general-purpose credit card as well as the second look retail private label credit card. We'll give you more guidance into 2024 probably next quarter, but it will take some time to really ramp up for it to be a material number in the P&L.

So I would look forward in the second half of next year, but we'll give you more of that specific guidance in the numbers as we get into looking into 2024. As far as where it will hit, the majority of it will come through the Acima segment. The Rent-A-Center segment will benefit from some of the general-purpose credit card, but all of the private label credit card on the retail side will come through the Acima segment.

Operator^ Our next question comes from John Rowan with Janney Montgomery Scott.

John Rowan^ Just one quick question for me, and I apologize if you covered this earlier. I had to hop off for a second, but I believe that you guys said that there was a slight reduction in credit quality of applicants for the quarter, and I'm just trying to remember if that foots or it doesn't foot with prior comments about the quality of applicants coming in at the top of the funnel indicating whether or not there was a trade down, because if I'm remembering correctly that was part of the call there that were seeing better front applicants at the top of the funnel. And so we do believe we're seeing trade down. Can you just help me understand the comments today versus prior comments?

Fahmi Karam^ So the comment around weaker profiles was really related to the Acceptance Now business and seeing some of that softness that we mentioned previously on and isolated to those retailers and those merchants really around the furniture side. But generally speaking, if you look at our third-party scores, they're still elevated year-over-year. Mitch mentioned it earlier in the call, but we did see a run-up in those third-party scores at the beginning of the year. It's probably, I would say stabilized over the last few months. But the consumer is very resilient.

They're still under pressure. Inflation is still very high. The discretionary spending is still very limited and tough out there. But generally speaking, at the top of the funnel, we're seeing better scores and hopefully that continues as people above us continue to tighten. It could be a nice tailwind for us in 2024.

It's not in any of our guidance that we've given to date but could be out there for us if it continues to come in at the top end of our apps.

Mitchell Fadel^ And just a little more color on what Fahmi was just explaining where that's the, we are referring to the legacy Acceptance Now business a little weaker coming in, and it's mostly because more of the business with those retailers is coming from e-comm and they're doing a lot more furniture.

A couple of them are doing a lot more furniture online, getting the orders generated online and we're seeing some weakness in the customer coming through there. And one of the reasons we're hurrying, and by early next year, we'll have everybody converted over the Acima platform is because it does a better job from an e-comm standpoint.

You haven't heard us talking over the years about the legacy business that we want to get it to a different underwriting level quite as much as you've heard it today, but it's really because that e-comm business is growing over there and we're excited about the benefit by getting it over to the Acima side because it can do a better job identifying the risk in those people. So that's really what it was all about, just seeing outside and really one level down from the A Now legacy business is the e-comm is, where the weaker stuff's coming through. And we'll have that over on the Acima side and some of our partners by the end of this year, but all of them by early next year.

Operator^ Our next question comes from Alex Fuhrman with Craig-Hallum Capital Group.

Alex Fuhrman^ Hi guys, just quickly for me, there's been a lot of talk about trade down in terms of credit. Curious if you're seeing your customers trading down just in terms of what they're buying in your stores and with your partners on the Acima side as well. Are you starting to see people making smaller purchases or gravitating away from name brands at all?

Mitchell Fadel^ No, we really aren't. We're not really seeing that. You're are getting here a little more about that probably at retail than when you think about small weekly payments that a lease offers or monthly payments for that matter. But when you think about a 55-inch TV at Rent-A-Center being $20 a week and the 75-inch TV being $26 a week, and those are close, so those aren't exact numbers, but $6 difference a week, you won't see much trade down. Now maybe a retailer that one of the TVs is a $1,000 and the other one's $500, they'll see trade down.

But when you have the low weekly payments, you can return at any time. So if you get in over your head, you could in fact not just return it, you could switch to the smaller one. If you need the $20 TV instead of the $26 one, you could exchange it for the smaller ones.

So there's not much reason for trade down with our lower weekly payments as compared to traditional retail.

Operator^ Our next question is comes from Carla Casella with JP Morgan.

Carla Casella^ You gave some guidance on free cash flow. Can you just talk about some of the components of the working capital or specifically more the merchandise purchases that you'll have to make much of that? Is that driving the full difference in your free cash flow? And how should we think about that as we roll into '24?

Fahmi Karam^ It's a little bit hard to hear you, but I think it was a free cash flow question. And yes, we did end up lowering our guidance for the year slightly this quarter compared to last quarter, but very much in line with where were earlier in the year. And I think it's a positive story from a standpoint of GMV has come in higher than what we had initially thought and ramping up nicely in the fourth quarter.

And same with the Rent-A-Center side of the business of replenishing that inventory for the holiday push. And so we expect that to continue to be a draw on free cash flow next year as well as we look into continuing to grow on both of the segments.

So coming off of 2022 with a heavy free cash flow year coming in with that year with a really big portfolio, with comps down at Acima at 20% we were able to generate a lot of free cash flow in 2022.

Still very strong in 2023 but we're starting to see that growth in the second half of the year that we kind of predicted and that should continue into 2024 so we'll get to more of a normalized level this year and then into growth mode into next year. So expectation is that it will continue to be very strong but probably a little bit less than '24 than we had in '23.

Carla Casella^ And then the active merchant locations, you mentioned you continue to add a different additional locations. Have you said the percentage growth overall you see in those in fourth quarter or next year?

Fahmi Karam^ We're up low single digits on the quarter and that's been pretty consistent over the last couple. And so I would say outside of us winning a big national account or enterprise account, I would expect that kind of percentage to continue quarter over quarter.

Mitchell Fadel^ Yes. Low to mid-single digit growth in merchants. And again, I mentioned it earlier, Carla, not just growth is what we're all about and that's important, but also you got merchants that you're in now that you can enhance your position by having the best alternative for the customer. I don't mean best alternative price wise, but the easiest transaction to make on the website, things like that. So if you have the less friction than maybe the one of the other ones they're using in that store, you can enhance your position and so forth.

So we're focused on continuing to grow that low to mid-single digits with the small mid-size players, but also enhance our position within each one we're in, as well as obviously we've got a whole team working on larger national accounts that have such a long sales cycle to them.

Carla Casella^ And have you said how many are you exclusive in?

Fahmi Karam^ No, we don't. The big ones we're in, most of the big ones we're in, we are exclusive but no, we don't disclose that number. It's not the easiest number to get, when you think about having over 30,000 small and mid-size stores out there where the Acima products in there but we look at it and we know we're improving it because we're seeing our position enhanced in a lot of cases, but we don't disclose the exact number or anything. It is a focus of ours. We do push the sales team to ask for exclusivity.

And if we can't get exclusivity, how do we get first look instead of our existing merchants. So it is a focus of ours and that's the enhanced position has gone. That focus has helped a lot.

Mitchell Fadel^ Exactly.

Operator^ I'm showing no further questions at this time, so I would like to now turn it back to Mitch Fadel, CEO for closing remarks.

Mitchell Fadel^ Well, thank you and thank you everyone for joining us today. We appreciate your time as you look at look at the quarter and our guidance going forward. Another good quarter. I want to thank you for your support, but also thank all of our employees all the way from our executives and the people like Anthony and Tyler that are running these segments very successfully right now, all the way to every employee in the company. We're executing, of course not a 100% because we never do, but we're executing at a high level and we'll just keep that going. Thank you everyone.

Operator^ Thank you for participation in today's conference. This does conclude the program and you may now disconnect.