Rent-A-Center(Q1 2022 Earnings)

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Corporate Speakers:

- Brendan Metrano; Rent-A-Center, Inc.; VP of IR
- Mitchell Fadel; Rent-A-Center, Inc.; CEO & Director
- Maureen Short; Rent-A-Center, Inc.; Executive VP & CFO

Participants:

- Kyle Joseph; Jefferies LLC; Research Division, Equity Analyst
- Robert Griffin; Raymond James & Associates, Inc.; Research Division, Senior Research Associate
- Jason Haas; BofA Securities; Research Division, VP
- Anthony Chukumba; Loop Capital Markets LLC; Research Division, MD
- John Rowan; Janney Montgomery Scott LLC; Research Division, Director of Specialty Finance
- Bradley Thomas; KeyBanc Capital Markets Inc.; Research Division, Director & Equity Research Analyst
- Unidentified Participant; JPMorgan; Analyst

PRESENTATION

Operator^ Good day, ladies and gentlemen, and thank you for standing by. Welcome to the Rent-A-Center First Quarter 2022 Earnings Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded. (Operator Instructions) At this time, I would like to turn the conference over to Mr. Brendan Metrano.

Brendan Metrano^ Good morning, and thank you all for joining the Rent-A-Center team to discuss our results for the first quarter of 2022. We issued our earnings release after the market closed yesterday. The release and all related materials, including a link to the live webcast, are available on our website at investor.rentacenter.com. On the call today from Rent-A-Center, we have Mitch Fadel, our CEO; and Maureen Short, our CFO.

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

Rent-A-Center 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. Please refer to our first 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'll turn the call over to Mitch.

Mitchell Fadel^ Thank you, Brendan. Good morning, everyone, and thank you for joining the call today to review our results for the first quarter of 2022. I will begin today's call with some high-level comments on the company's key objectives and progress followed by a review of financial and operational highlights and then an update on our plans for the year. After that, Maureen will provide a more detailed review of our financial results, and then we'll finish, of course, with Q&A.

Following the challenges we had at Acima in the second half of 2021, our primary objective for this year is getting the company back in a position to successfully execute the growth strategy we developed last year with the acquisition. Over the past number of months, we identified issues that drove Acima's underperformance, developed a plan of action and began implementing solutions.

In addition, as previously announced, we've recently completed a leadership transition at Acima. So we are encouraged with our start to the year with early indications that our adjustments are having the desired effect and first quarter financial results coming in above the midpoint of our guidance ranges.

While there are growing external headwinds this year, including the wind down of government stimulus programs, we believe the operational and financial progress we have made thus far have the company on a path to achieve 2022 financial targets, and we've reaffirmed our full year guidance.

Consolidated revenues were $1.16 billion, down 5.8% year-over-year on a pro forma basis with Acima down 8.1% and the Rent-A-Center business segment down 1.2%. We believe the decline in revenue was attributable to the performance of Acima lease vintages underwritten in the latter part of 2021 using assumptions that lag worsening customer payment behavior, negative effects on customer incomes from government stimulus programs winding down in 2021 and the Omicron breakout in January.

Consolidated adjusted EBITDA was $99.5 million with a margin of 8.6%, negatively impacted by elevated loss rates and delinquencies that we believe largely resulted from Acima underwriting practices in the second half of 2021 as well as post stimulus changes in customer payment behavior. Higher labor costs in Rent-A-Center stores and higher corporate costs related to investments also contributed to margin contraction.

Non-GAAP diluted earnings per share of $0.74 for the first quarter was above the midpoint of our guidance range of $0.65 to $0.80. We also generated almost $189 million of free cash flow in the quarter compared to about $124 million in the prior year period, providing us with the flexibility to invest in our business and reduce debt.

In our business, lower growth periods result in higher free cash flow, which underscores the strong cash flow attributes of our business and provides us with that significant flexibility. Focusing in -- on segment performance, Acima's first quarter top line trends were generally in line with the assumptions behind our first quarter guidance. GMV of

$398 million declined 21% year-over-year on a pro forma basis, reflecting the effect of tighter underwriting, the January Omicron outbreak and cycling over strong GMV growth in the prior year period that benefited from government stimulus.

In fact, our first quarter 2-year GMV growth is a positive 10%. The shift in underwriting is part of a broader set of changes that Acima did to address the issues that occurred in the latter portion of 2021. As previously noted, we did not anticipate the extent or pace of the declines in customer payment activity. Although we made adjustments to our underwriting, the initial changes in 2021 were in hindsight, not sufficient to address developments in the external environment.

Because we're a portfolio of business, these earlier vintages -- lease vintages take time to cycle through our results, and we expect to see the impacts of those vintages through the end of the second quarter. The changes in underwriting that were implemented during this past first quarter drove significant improvement in first payment missed or what we call FPM rates, which is the best early indicator of future loss rates and yield.

Overall, FPM rates declined over 30% in March from their peak in December. We believe we are clearly on the right track when it comes to adjusting to the current macro environment. The Rent-A-Center segment started the year off with another good quarter. Revenues of $519 million declined 1.2% year-over-year, and we're above the assumptions behind our first quarter guidance with same-store sales down 1.1%.

Importantly, we are cycling over 15.4% revenue growth in the prior year, which translates to an impressive 2-year stack revenue growth of 14%. This momentum was reflected in the lease portfolio also, which ended the quarter 5.6% above last year. E-commerce continued to contribute to growth with revenues up about 4% and now accounting for about 23% of segment revenues in the quarter.

Adjusted EBITDA margin was 20.7% for the quarter even with cost pressure from losses and wages, fuel prices and inflation in the cost of certain products we lease and sell. On the strategy front, we continue to advance our omnichannel capabilities by improving the customer experience with enhancements to our digital checkout process and launching functionality that allows customers to make payments via text messages or SMS.

We also expanded our extended aisle partnership initiative and added thousands of SKUs to our e-commerce platform available at other retailers in local markets. Looking forward to the rest of the year, the objectives we outlined in February remain in place. For Acima, we will continue to focus on initiatives that can benefit both near-term results and long-term capabilities like putting more resources and emphasis behind underwriting to optimize yield and loss improvements this year, but also to benefit our future underwriting.

We will also continue to develop high potential growth opportunities like the digital ecosystem and other new offerings in a manner consistent with our internal profitability goals.

For the Rent-A-Center business, the team has put together a compelling commercial plan that we believe can sustain and grow the portfolio beyond 2021 levels. The value proposition we provide to our customers continues to support solid transaction volumes and renewal rates despite the more challenging macro environment. In addition, we think our commitment to the local retail-centric RTO model, coupled with an improving e-commerce offering is enhancing our competitive position.

Additionally, we've proven in the past to be very resilient to recessionary pressures. Regarding our financial outlook, when we issued full year 2022 guidance back in February, it did not incorporate improvement in the macro environment over the year because there was so much uncertainty.

And even with continued uncertainty given the solid start to the year, progress with the changes at Acima and consistent performance of the Rent-A-Center business segment, we are reiterating our guidance of full year consolidated revenues of $4.45 billion to $4.6 billion, adjusted EBITDA of $515 million to $565 million, diluted earnings per share of $4.50 to $5 and free cash flow of $390 million to $440 million.

In addition, given the extent of noise and variability and trends related to the effects of government stimulus programs in 2021, we have provided guidance for the second quarter that was highlighted on our earnings press release. Also, I'm very pleased to announce that the company has taken a step forward in its ESG efforts with the production of our inaugural sustainability report for 2021, which will be available on our Investor Relations website.

In closing, first quarter results were in line with our guidance, and we believe changes in the Acima have placed the business back on the path of longer-term profitable growth.

We believe we have a solid game plan for the year that we think will allow us to effectively navigate a more uncertain business environment, while also positioning us for longer-term success. I want to thank the entire team for their continued effort and dedication as I continue to see tremendous opportunity in our future. And with that, I'll turn the call over to Maureen.

Maureen Short^ Thank you, Mitch. The first quarter was a step in the right direction for the company following a challenging second half of 2021. We achieved quarterly guidance targets, made good progress on key operational objectives and reaffirmed full year 2022 financial targets. Looking forward, we are cautiously optimistic about the rest of the year.

Although there are external headwinds from macroeconomic uncertainty and pressure on customers' income from the wind down of government stimulus programs, we believe that we have a solid plan to get the business back on the path of strong profitable growth and achieve our financial targets.

First quarter revenues of $1.16 billion increased 11.9% year-over-year on a reported basis and decreased 5.8% on a pro forma basis, with both merchandise sales revenues and rental and fees revenues down year-over-year. Merchandise sales revenues decreased as a result of fewer customers electing early payouts this year compared to the prior year period when government stimulus programs boosted discretionary income.

Rental and fee revenues were down because of the poor performance of Acima's lease vintages that entered the portfolio during the second half of 2021 prior to recent underwriting adjustments, which caused an increase in delinquencies that significantly outpaced top line growth.

This required us to increase our provision for delinquencies, which is treated as a reduction in revenue and caused rental and fees revenues to decrease year-over-year. Adjusted EBITDA of $99.5 million decreased 28.3% on a reported basis and 42.9% on a pro forma basis. Adjusted EBITDA margin was 8.6% in the first quarter compared to 14.2% for the prior year period, on a pro forma basis.

The margin contraction was the result of higher loss rates for both the Acima and Rent-A-Center segment, higher delinquencies at Acima and higher operating costs, mostly from labor. Below the line, net interest expense was $18.9 million compared to $11.9 million in the prior year, reflecting a higher debt balance in the current year.

The effective tax rate on a non-GAAP basis was 25.2% compared to 19.7% in the prior year period. Ignoring the effects of a net operating loss, diluted average share count was 60.1 million in the quarter, compared to 66.3 million in the prior year period.

GAAP loss per share was $0.08 in the first quarter compared to a diluted earnings per share of $0.64 in the prior year period and included onetime costs related to the Acima transaction and integration. After adjusting for special items that we believe do not reflect the underlying performance of our business, non-GAAP diluted EPS was $0.74 in the first quarter of 2022 compared to $1.32 in the prior year period.

We generated $188.9 million of free cash flow in the quarter compared to $124.4 million in the prior year period, mainly due to a beneficial swing in working capital in the current year. We returned $21.1 million to shareholders through a $0.34 per share quarterly dividend.

At quarter end, the company had approximately $360 million remaining on its current share repurchase authorization. In addition, we had a cash balance of $95.7 million, gross debt of $1.4 billion after paying down $170 million of the revolver, net leverage of 2.3x and available liquidity of $439 million.

Turning to segment performance. Acima GMV was down 21.2% year-over-year on a pro forma basis, although it was up 10% on a 2-year stacked basis. The decrease was an expected result of the underwriting adjustments we initiated to reduce losses and improved yields, which had the effect of lowering approval rates, conversion rates and funded leases.

GMV was also negatively impacted by less activity for merchant partners compared to the prior year, which appears to stem from the wind down of government stimulus that boosted customer discretionary income in 2021.

The Omicron variant likely further pressured merchant activity in January. These GMV headwinds were partially offset by year-over-year growth in Acima's active merchant count. Acima revenues declined 8.1% year-over-year on a pro forma basis. The biggest factor behind the decline was poor performance of lease vintages from the second half of 2021 that I described earlier in the comments for consolidated results.

Similarly, merchandise sales revenues also declined due to elevated payouts last year. On a positive note, our digital growth initiatives, including e-commerce and the ecosystem continued to contribute incremental revenues in the quarter.

Skip/stolen losses in the Acima segment increased approximately 400 basis points year-over-year to 12.6%, driven by a return to more normalized loss rates following the wind down of government stimulus programs and higher charge-off rates on poor performing lease vintages from the latter part of 2021.

As Mitch noted, the changes we have made in underwriting in recent months are showing strong indications that loss rates should improve in the back half of the year once the vintages from last year cycle through the portfolio.

As you may recall, the average length of the lease at Acima is approximately 6 months. Adjusted EBITDA margin declined 690 basis points on a pro forma basis to 4.8%. The key factors that drove margin contraction were higher loss rates and a 220 basis point decline in gross margin related to a higher provision on delinquencies, primarily due to lease vintages written in the second half of 2021.

Rent-A-Center segment revenue decreased 1.2% in the first quarter with same-store sales down 1.1%. Rental and fees revenue increased year-over-year, benefiting from the lease portfolio finishing the quarter 5.6% higher than last year. However, rental revenue trends were more than offset by a decline in merchandise sales revenues.

As noted earlier, merchandise sales were negatively impacted by fewer people electing early payout options in the current year. Skip/stolen losses increased 120 basis points year-over-year to a more normal level of 3.9%. Adjusted EBITDA margin was 20.7% and declined 330 basis points year-over-year due to higher loss rates and wage increases for certain in-store positions.

Turning to the outlook for the year. My comments will focus on providing supplemental information for the full year financial targets that Mitch discussed and have been disclosed in our earnings release. I will also provide comments on quarterly trends.

Starting with full year comments, for Acima, we expect recent tightening in underwriting, the effect of cycling over 2021 stimulus programs and macro headwinds will result in a high single-digit to low double-digit decrease in GMV on a pro forma basis.

Pro forma revenue for Acima is expected to be down mid- to high single digits and adjusted EBITDA margin is expected to be in the low double digits. This assumes elevated delinquencies and loss rates on poor performing leases from 2021 will continue through the first half of 2022 and then improve during the second half of the year when leases originated under new and more conservative assumptions comprised more of the lease portfolio.

For the Rent-A-Center business segment, we expect revenues and same-store sales will be down in the low single-digit range. Adjusted EBITDA margin is expected to be in the low 20s and modestly lower year-over-year, driven by normalized loss rates and higher labor costs. The Mexico and franchising businesses are expected to generate similar results to 2021, while corporate costs are expected to increase mid-single digits.

The second quarter is also expected to be challenging from a year-over-year perspective, facing many of the same headwinds experienced in the first quarter. We expect revenues of $1.045 billion to $1.075 billion; adjusted EBITDA of $114 million to $127 million, excluding stock-based compensation of approximately $5 million; and non-GAAP diluted EPS of $0.95 to $1.10.

Acima's GMV growth is expected to be similar to the first quarter, as we plan to maintain relatively tight underwriting assumptions, and comping over 43% pro forma growth in the second quarter of 2021.

To put that in perspective, we expect second quarter GMV will be up around 20% on a 2-year stacked basis, which we think is at least in line with the market. GMV growth should improve progressively in the second half of the year, with the fourth quarter getting back to roughly flat year-over-year. We expect the revenue growth for the Rent-A-Center business segment to be down low single digits year-over-year and Acima to be down double digits.

EBITDA margin for both of the key business segments should improve sequentially from the first quarter. For the back half of the year, we expect consolidated revenues will be modestly skewed to the fourth quarter with trends improving from the third quarter to fourth quarter for both the Acima and Rent-A-Center business segments. We expect earnings will be more skewed to the fourth quarter than revenues, reflecting progressively better delinquencies and loss rates.

Lastly, reaffirming our 2022 guidance today reflects modest upside to first quarter guidance being essentially offset by the softer macro environment that has evolved over the past couple of months.

Accordingly, the projections underlying our guidance assumes the current macroeconomic conditions will continue for the rest of the year. There is no change in capital allocation priorities since our last earnings call.

We plan to use most of our free cash flow to pay down our revolver and make progress towards our longer-term leverage target of 1.5x or lower net debt to EBITDA. In terms of returning capital to shareholders, our quarterly dividend of $0.34 offers a very compelling yield to investors and we evaluate opportunistic share repurchases. Thank you for your time this morning. I'll now turn the call over for your questions.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) Our first question or comment comes from the line of Kyle Joseph from Jefferies.

Kyle Joseph^ And thanks for the -- all the color provided in the presentation and release. Obviously, a lot going on both macro and at Acima, so just kind of trying to dig through the weeds here. In terms of GMV growth, can you kind of give us a high-level breakdown of how much of that is kind of macro? And how much of that is more specifically the underwriting changes and kind of give us a reminder of the timing of the underwriting changes so we can kind of think about how trends improve there over the remainder of the year and into '23?

Mitchell Fadel^ Sure, Kyle. Yes. On the GMV growth, when you think year-over-year, the biggest -- certainly, the tightening of underwriting was an issue, and it's an issue when it comes to GMV. And we tightened starting last fall. Obviously, it wasn't tight enough in the vintages and then really additional tightening started in the first quarter -- early in the first quarter and throughout the first quarter.

So when we think about it, one of the bigger issues besides the tightening of underwriting is what we're comping over. As we mentioned in the prepared comments, our 2-year comp in the first quarter is 10% on GMV. Our 2-year stack number for the second quarter is forecasted to be over 20%. So still very high numbers when you think about it on a 2-year basis. As the comps ease in the latter half of the year, I think Maureen said in the prepared comments, we'd expect to be flat by the fourth quarter.

And then long term, we would still anticipate double-digit growth when you think about 2023 and beyond, maybe higher than that, depending on if we get larger account wins and so forth but being in the double-digit range going forward after we get over these tougher comps, the tighter underwriting as well as the -- when I say tougher comps, obviously, the stimulus last year is driving a lot.

That's still a lot of growth out there. We added almost 1,300 net active merchants in the first quarter. So still a lot of growth out there, just some tough comps. And like I said, the 2-year numbers seems to be, as Maureen said, where we'd like to see them in merchants.

Kyle Joseph^ Got it. And then just on the Rent-A-Center side, obviously, losses are up there. But a lot of that can be ascribed to macro factors. Can you give us a sense for where you see long-term losses at the Rent-A-Center segment shaking out kind of once we lap all the stimulus and everything.?

Mitchell Fadel^ Yes. I think we've always said the normalized range is 3 to 4. It came in at 3.9 in the quarter, so a little higher than we want because they're at the high end of the range, but they're in that range, and we'd expect them to be in the middle of that range for the year, in the 3% to 4% range.

So it's really just a normalization, maybe 30 or 40 basis points higher than the midpoint of that range with all the growth they've had in the last couple of years. But really in line, really a good quarter on the Rent-A-Center side when you think about where the portfolio ended, a flat comp roughly coming off of what's the last 2 years, 15% last year. I'm talking about for the year and 10% in 2020.

You're talking about 25% growth over 2 years and then to be flat this year and to be forecasted roughly flat, maybe down a little bit for the year. It's pretty impressive when you consider what holding on all that base that we had in the last 2 years.

Kyle Joseph^ Yes. Yes, totally agree. And then last one for me. Just modeling, Maureen, I think you gave us some share count guidance -- share count for guidance? Is that consistent? And can you remind us what number that is for '22?

Maureen Short^ Sure. The share count in the first quarter was 60.1 million.

Kyle Joseph^ Okay. And then for '22, the adjusted EPS number, do you have a number of what that's based on for the share count?

Maureen Short^ It's pretty similar. It's [50.5] for the full year.

Operator^ Our next question comment comes from the line of Bobby Griffin from Raymond James.

Robert Griffin^ Just Mitch or Maureen, I want to first check -- I mean, obviously, tightening trends here in Acima to kind of get the portfolio back in line. Just curious what feedback has been from your customers? I know customers focus on approval rates, purchasing dollars of approval that you can do. So these tightening trends is definitely a different environment versus what they are used to with Acima. So just any anecdotal feedback from customers as you kind of go through this process to get the portfolio back in line.

Mitchell Fadel^ Yes. Good question, Bobby. And when you think -- I know when you say customers, you're talking about our retail partners.

Robert Griffin^ Yes.

Mitchell Fadel^ It's all about where you start from. I mean our tightening rate -- tightening underwriting and our approval rates are in line historically where Acima was -- when you look at 2018, '19, even 2020, it really was a matter of what happened in 2021. And so when we look -- when -- like I mentioned in my prepared comments, the FPM rates, first payment missed rates being down 30% in March from the peak in December, those are just historically in line with where they always are and the same thing with approval rate.

So it's not like we're hearing from retail partners said, "Oh my gosh, you're tighter than your competition or things like that." I think in this environment, everybody has probably tightened a little bit. But we're still -- we're not -- it's not like we're tighter than we were going back and looking 3 years before 2021.

Robert Griffin^ Yes. And that was actually the second part of the question. Do you think now -- it kind of seems like everybody across the space, at least on the virtual side, has tightened a little bit because the portfolio has got a little bit out of whack as we came back in normalization. Have you seen any favorable trends kind of in the competitive environment where maybe it's a little less competitive and everybody can kind of grow into this virtual business a little bit more friendly? Or is it still probably every bit as competitive for new customers and dollars out there as it always has been?

Mitchell Fadel^ Yes, I think it's -- there is -- it does feel and just listen to comments of other companies -- public companies, certainly, there is an overall tightening. So I think it's pretty similar, though, as far as the competitive environment. But we're -- what we haven't seen yet, we -- but as you know, we historically see as the tightening above us helps us when we get into these times with higher interest rates and as the economy tightens up.

And even though we haven't seen it yet, we're optimistic, at least -- cautiously optimistic we'll see some of that as the year goes on and the funnel widens and there's really no reason to think that those anti-cyclical attributes relating to tighter credit above us wouldn't apply going forward.

Like I said, we haven't seen them yet, but I think that's coming when you think about interest rates and spreads and so forth. So like I said, we're optimistic we'll see that again. And although it's not like we forecasted any -- not like that's forecasted in our plan either, but we are expecting to see that.

Robert Griffin^ Okay. Yes. And then maybe if that was to happen and play out. So right now, consumer spending still remains pretty resilient. There's obviously some shifts going on between durables and services. But if that tightening impact plays out as the potential with interest rates and inflation running through the economy.

When you start to see the pool -- the customers get pushed out in your rent-to-own pool. How long does it take to really flow through the P&L where you see that benefit? Is it a 6-month lag, 9-month lag from when we start to see the changes in the economy?

Mitchell Fadel^ No, I think you start to see -- the build over that 6 to 9 months, but you start to see them right away. I mean every month, you write a lease, you fund a lease, you start to make a little money on that lease. So I think it builds maybe to a crescendo in 6 to 9 months, but it starts pretty much as soon as you start seeing that pushing down, you start adding -- beating your GMV numbers and so forth.

And I think -- when you think about the spending, it is very resilient. And it's everything you hear on the news and so forth, although the reason we would expect to see tightening above us, when you get down below prime and get in near prime and certainly subprime, that customer, it's not in the same shape as the -- what we might hear every morning on CNBC or something, right? That customer we deal with is not with the inflation and gas prices and that kind of stuff, they're not in the same shape.

So when you get down in the near prime and below prime and especially the subprime, you're going to have to be careful if you're writing loans. So that's why we would -- that's why we normally see the tightening, and we would expect to see it sometime this year as well.

Robert Griffin^ Okay. I appreciate all the details. Best of luck in Q2 and the end of the year.

Operator^ Our next question or comment comes from the line of Jason Haas from Bank of America.

Jason Haas^ So first one is on the guidance. It does imply a pretty big acceleration in the back half of the year. And I appreciate all the color that you gave, but I'm curious just what gives you confidence that you will see that acceleration through the year? And maybe by segment, I mean, is a lot of that acceleration going to come from Acima? Or is there going to be some acceleration across the Rent-A-Center business and franchise in Mexico as well?

Maureen Short^ Sure. I can take that. So what gives us the confidence is a lot of what needs to happen to make the improvement from the first half to the second half is simply getting the leases -- the underperforming leases from the latter half of 2021 for them to cycle through the system. And so that will improve provisions for delinquencies as well as loss rates in the Acima segment.

The average lease lasts about 6 months. So we know that by the second quarter, we'll have worked those through most of the system. We also expect the second half will have more profitable leases due to the underwriting improvements that we've made. So new leases that we write in the -- even the beginning of this year and all throughout the second quarter will be more profitable leases, so we'll have higher revenue, lower delinquency rates and lower provision adjustments.

And then we should be through the adjustment period our customers went through when stimulus ran out. And so that should also help lease performance. We've also got the Acima leadership team very focused on improving merchant acquisition and productivity.

So we'll see better GMV growth rates in the second half versus the front half. And then as Mitch mentioned, we may see some of the near prime customers falling into our funnel. But the main improvements are in the Acima segment, reducing Acima loss rates by about 400 basis points between the first and second quarters and reducing the provision for delinquencies by about 200 basis points in the Acima segment.

There is some improvement in the Rent-A-Center segment, not nearly as much as Acima, but we are expecting the Rent-A-Center portfolio to increase in the fourth quarter like it normally does. There's better seasonality in the fourth quarter for both segments. And then we're expecting collections to improve in the second half in the Rent-A-Center segment. There's also some cost efficiencies we're expecting, but generally, big buckets are Acima improvement and lease performance.

Mitchell Fadel^ Yes. This is the big one, Jason. I would just add on to that. That's -- there's really nothing to add to Maureen said, except just to do a little math when you think about the 400 basis point improvement in losses as these leases from last year run through Acima. I mean just think about what 400 basis points as per quarter or on an annual basis because people want to take our current number and look at run rates and so forth.

So if you think annual basis, you're talking 400 basis points high even in the second quarter and that's -- based on our guidance, just call it $1 run rate, 400 basis points is on an annual basis. If you use that as a run rate, you can see -- it would assume a $2 billion business roughly from a revenue standpoint.

So it adds quite a bit. And you think about last summer too -- the third quarter last year, we were at $1.52 in diluted EPS. And I'm using the third quarter, not the first -- the first or second quarter last year was even higher, but obviously stimulus driven. And there's still obviously some stimulus in the third quarter last year, but it's not like we haven't done those numbers before. And when you just put a normalized loss rate in there, even if not a low normalized loss rate when you say 400 basis points under 12.5%, I mean 8.5% is not like that's the lowest.

We always said the range on the virtual business as 6% to 8%. So just take that 400 basis points and you start to get back to those numbers. And the same way those losses and the delinquency reserves that Maureen talking about took $1.50 down below $1 really quickly. It snaps back when you don't have to put those reserves up or you have those higher losses just as quickly.

Jason Haas^ That's been really helpful color. As a follow-up question, I think Maureen just mentioned it. But I was curious about the leadership change at Acima. Could you just talk to what the rationale was for having that leadership change? And any plans to run that business differently? I appreciate what you've said about being more -- a little more tied with the decision there, but curious if there can be any other changes to expect in that business?

Mitchell Fadel^ Yes. I think we felt like it was just time to make some changes. And it was really not just about any 1 person or as a team change as well. Obviously, with the founder being more involved now Aaron Allred, the -- but we also brought back a key engineered -- tech leader that was part of growing the company from the beginning, elevated a few people that have been there for many, many years.

We really trying to build a long-term, sustainable team. Again, it's not just about any 1 person, it's really more team building. And I would expect besides the tighter underwriting that's already providing good results for us, as we mentioned. Yes, I think we'll see improvement from a sales standpoint, as the new team -- the newer team works on the sales function and so forth. So I don't think there's massive changes like the business is going to change. We're still testing the digital ecosystem.

We have look at that to make sure we're getting the right profit margins as we mentioned. So we're testing very thoroughly to make sure we get the right profit out of it, but we're still excited about what it can become and so forth. So that's not changing. Not so much a change, Jason, as I think we can get better in all aspects of the business.

Operator^ Our next question or comment comes from the line of Anthony Chukumba from Loop Capital Market.

Anthony Chukumba^ I guess my first question, it's kind of a follow-up to the prior question. With the change in leadership at Acima, is that and obviously, with the Acima the changes you're making in terms of tightening credit and getting the lease portfolio back in shape. Is it safe to assume that the lease pay card stuff that you guys were talking about like the virtual card? Is it safe to assume that's kind of more on the back burner now?

Mitchell Fadel^ I wouldn't say back burner. We've slowed the testing a little bit just to make sure we're at the right profit margins. We don't want to run too fast. This year is about fixing the underwriting, getting a sustainable long-term team in place, but continuing to test it.

So I wouldn't say back burner, Anthony, as much as just a good thorough test, and we're still excited about what it can become. There's still a lot of opportunity there for us to evaluate with the new leadership team there and figure out what the best way to use it is. So no, I wouldn't call it back burner, just we're still excited about it and maybe a little more prudent testing from a profitability standpoint.

Anthony Chukumba^ Got it. And then one, just somewhat related follow-up. So 1 of your retail partners, Conn's, recently announced they're going to bring lease to own in-house. And I know that's an account you guys were sort of sharing with American First Finance. But just -- how should we think about the -- and I know that it's not going to -- something that's going to happen overnight, but just like long term, how should we think about potential headwind of losing the Conn's talent?

Mitchell Fadel^ Yes, you're right, Anthony. It's not going to happen overnight if it does happen. But the -- I think the key to Acima is how diversified the almost 40,000 retail partners are. We are very diversified. No 1, 2 or 3 partners makes that much of an impact. Obviously, we want some of those bigger national accounts. But I guess the other -- the flip side of that coin is we don't have any accounts that are so large that that any 1 or 2 accounts would be a headwind that would be all that noticeable in the numbers.

I'm not saying we want to lose any accounts. We'd love to do business with Conn's forever. And hopefully, we will find a way to do business with them forever. But the point is it's a very diversified portfolio, and we really don't have that risk of any 1 or 2 or 3 partners really having that big of an impact.

Anthony Chukumba^ Got it. And good luck with the remainder of the year.

Operator^ Our next question comment comes from the line of John Rowan from Janney.

John Rowan^ I'm going to stick with a similar theme of questions. As far as 6 months ago or 9 months ago, you were talking about national partners with Acima. I'm wondering what the status there is with the management change. And whether or not the change in underwriting affects the sales process of trying to onboard a new large retail partner.

Mitchell Fadel^ No, I don't think so. Again, we're still very competitive. Maybe we don't have the highest approval rates like we did probably mistakenly had for 6 months last year. I wouldn't go out there and say we have the highest approval rates like we could have been saying last year. You never really know what all the competitions approval rate anyhow. But it's not that we're not competitive, we can be as competitive as anybody. Again, our approval rates are not sub where they were before last year.

They're not -- it's not like we're lower than 2019 or '20 so -- before we bought Acima. So I don't think that has any impact on that. Again, our approval rates are still very competitive. And just large retailers in general, as you know, John, it's a very long cycle. The new management team is focused on -- just as focused on national accounts as we have been prior. We haven't had a lot of any big signings yet.

We're talking to a lot of people. It's a very long cycle. The good news is we expect retailers to get more focused on it now that their comps are going to be tougher than maybe the last couple of years. It was hard to get larger retailers focused on it when they couldn't fulfill all the business they had. Tech resources were under pressure for integrations and things like that. So we expect retailers to be more focused now talking to tons of them, and it's a long cycle, and we're going to continue to work but there's no less emphasis on it than ever.

Operator^ Our next question comment comes from the line of Brad Thomas from KeyBanc Capital Markets.

Bradley Thomas^ I wanted to just follow up on the dialogue and trends with retailers. I would think with us entering a backdrop where consumers may need lease, sale and financing options more readily here that your retail partners may be more interested in working with you. Can you just comment a little bit more about what you're seeing from a door count perspective and how that pipeline of potential activations looks?

Mitchell Fadel^ Yes, I think you're spot on those comments. We think all retailers, small and large ones, are more interested now than they were a year ago or obviously, 2 years ago when the pandemic first started. I think I mentioned we added about 1,300 active locations in the first quarter.

So it's not like there's not a lot of sales going on out there. And that's part of how even with a tighter underwriting, as Maureen said, in the GMV number in the second quarter, similar to the first quarter, that our 2-year GMV number still be over 20%. So we're still adding a lot of locations, like I said, almost around 1,300 in the first quarter.

So there is more interest. Not that we weren't adding them last year, but there does seem to be at least a little bit more interest spread from retailers, and we're optimistic we're going to be able to continue to add the regionals, and we're going to work real hard on those national accounts as well.

Bradley Thomas^ And Mitch, can you just remind us, is the decisioning in your Acima segment, is that all on 1 process now versus the legacy business you have and Acima? And can you just talk about what you've done to try to further enhance the accuracy in the ability to predict well with your decisioning?

Mitchell Fadel^ Yes. It's -- all the virtual business is on the same system. Some of the staff business -- there's still a few staff partners to convert to the Acima software and therefore, their decisioning. So it's mostly all on 1 system, but there is still a few retail partners to convert over. And I think the tools have been there. We've added a few tools to the underwriting process as well. There's always new tools. We can probably add tools every week. You got to be careful not to chase every single one of them.

But when I say tools, things they can add into the process, fraud detectors and all those kind of things. And the team out there is adding things they think they need. A lot of it -- most of what our missteps were, Brad, we're just philosophical and from a leadership standpoint, just pushing too hard for volume.

It's not like they didn't have enough tools. But again, they're still adding tools and different products to it. I'm not the tech guy, although I could throw out a couple of names, even though I'm not exactly positive what they do. I could sound smart if I want to throw out a couple of brand names of things they've added to the decisioning.

But we got a great team out there in Salt Lake, and they're adding the fraud detectors that they think they need to add. And obviously, the numbers are working really well, even though our approval rates are in line with where they were pre-2021. And the FPM rates have come right back in line as I mentioned, they're 30% lower than they were when they peaked in December. So obviously, we're about 30% on a line as the year came to an end.

And then I'm sure as the year goes on, we'll add 1 or 2 more tools because like I said, in the tech world, there's always some new product to add that can maybe get us a little bit smarter and they're always working on that, the team out there. So we're really pleased with what's happened with the underwriting, obviously, in the numbers so far this year.

Bradley Thomas^ That's very helpful, Mitch. If I could squeeze one more in just on the Acima outlook for margins. Obviously, we're an unusual carry here, as we're lapping stimulus and you've done some tightening. How should we think about what the medium-term margin outlook is for Acima, I think maybe more of a 2023 sort of number. And do you still think mid-teens adjusted EBITDA margin is a reasonable target maybe longer term after you get past some of the growth initiatives that you're still making in the business?

Maureen Short^ Yes, Brad. So as you can see in our guidance, we expect substantial improvement in margins in the -- from the front half of the year, which is still negatively impacted by the underperforming leases to the back half, will average around 12.5% EBITDA margin, if you look at our guidance, to get to that double-digit EBITDA margin for the full year.

And so you can see we'll end the year not quite to mid-teens. I would say our longer-term rate is in the 12% to 13% range for the Acima segment with how we're viewing things right now, that could change. We're obviously not giving 2023 guidance. But as we stand right now, it's probably closer to 12% to 13%.

Operator^ Our next question or comment comes from the line of Carla Casella from JPMorgan.

Unidentified Participant^ This is Mike on for Carla. Just 2 ones from us and hopefully quick. You guys recognize you guys sit down a little bit of the revolver balance this quarter. Do you guys expect to pay more either in the second quarter or by the year-end? And then I'll ask my second question after that.

Maureen Short^ We are more focused this year on reducing our leverage, just given the macro uncertainty. So there is a chance that we pay down debt further throughout the rest of the year.

Unidentified Participant^ Great. And the second one is. Can you guys give us any sort of parameters to help forecast think about the purchase of rental merchandise for the core business?

I recognize that Acima kind of moves directly with sales, I kind of touch on that. Are your stores, would you say that they're under-inventoried in certain categories, just given that as well? Any context or color would be helpful there.

Mitchell Fadel^ No, good question, Mike. No, we don't feel like we're short in any products in the stores. Like any retailer with electronics in their stores, we could use a few more PS5s on the shelf.

So I think Anthony would agree with that, Anthony Blasquez runs the Rent-A-Center segment. I think he takes a lot more PS5s if you could get them. But other than that, no, in fact, as I mentioned in my prepared comments, we added thousands of SKUs to our website recently, extended aisle, if you will, through other retail partners. So no, from an inventory standpoint, our Rent-A-Center is in a really good shape.

Operator^ I'm showing no additional questions in the queue at this time. I'd like to turn the conference back over to Mr. Mitch for any closing comments.

Mitchell Fadel^ Thank you very much, and thank you, everyone, for your time this morning for your interest in us. We certainly are happy to report numbers in line with our guidance and to reiterate our annual guidance.

It was a tough latter half of last year and a tough start to this year from a standpoint of the -- having to add to the delinquency reserves and losses and so forth. But we know what we did wrong, we know we need to fix, and we're on the right track. And a lot of the metrics are coming online really well, and we're pleased with that, and we look forward to reporting back to you next quarter. Thank you, everyone.

Operator^ Ladies and gentlemen, thank you for participating in today's conference. This concludes the program. You may now disconnect. Everyone, have a wonderful day.