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EZCORP, Inc. (EZPW)

Q1 2020 Earnings Call

CORPORATE PARTICIPANTS

Michael Kim
Investor Relations Officer, EZCORP, Inc.

Stuart I. Grimshaw
Chief Executive Officer & Director, EZCORP, Inc.

Daniel M. Chism
Chief Financial Officer, EZCORP, Inc.

OTHER PARTICIPANTS

John Hecht
Analyst, Jefferies LLC

Gregory R. Pendy
Analyst, Sidoti & Co. LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon, ladies and gentlemen, and welcome to the EZCORP First Quarter of Fiscal 2020 Earnings Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will follow at that time. As a reminder, this call may be recorded.

I'd now like to turn the conference over to Michael Kim, Investor Relations. Please go ahead, Michael.

Michael Kim

Investor Relations Officer, EZCORP, Inc.

Thank you and good afternoon, everyone. During our prepared remarks, we will be referring to slides which are available for viewing or download from our website at investors.ezcorp.com.

Before we begin, I'd like to remind everyone that this conference call as well as the presentation slides contains certain forward-looking statements regarding the company's expected operating and financial performance for future periods. These statements are based on the company's current expectations. Actual results for future periods may differ materially from those expressed or implied by these forward-looking statements due to a number of risks or other factors that are discussed in our annual, quarterly and other reports filed with the Securities and Exchange Commission. And as noted in the presentation materials and unless otherwise identified, results are presented on an adjusted basis to remove the effect of foreign currency fluctuations and other discrete items.

Now, I'd like to turn the call over to Mr. Stuart Grimshaw. Stuart?

Stuart I. Grimshaw

Chief Executive Officer & Director, EZCORP, Inc.

Thanks, Michael, and good afternoon to everyone. If I turn briefly to page 4, I'll summarize a little bit the positioning we have coming out of the first quarter for the 2020 financial year. Our clear focus has always been on meeting our customers' need for cash and we haven't wavered in this intent over many years. While PLO remained relatively flat across the year, we saw a good PSC improvement in Latin America with pawn service charges up 5% highlighted by a monthly yield improvement, up 80 basis points on an adjusted basis.

Merchandise sales were up 18% in Latin America reflecting the strong cash position of our customers. However, merchandise margins were impacted by a movement of aged inventory across the quarter, which Danny will touch on a little later. We will continue to focus our efforts on moving inventory, particularly aged and aging, and building cash balances in the company. After a few quarters of negative [ph] IT (00:02:35) performance, this quarter had uninterrupted service at the stores, and pleasingly, all stores in the US and Mexico are now operating on the new point-of-sale system.

We also continue to focus on the de novo expansion of our business in Latin America with four opened in the first quarter with a further nine currently under construction. We plan to open approximately 40 for the year. While we continue to see opportunities for acquisitive execution, the prices do not merit the capital being [ph] sought by vendors (00:03:04) and we will continue to maintain our discipline in this regard.

Lana went live in the first quarter and we have three pilot stores in Florida currently integrated into the Lana offering. We anticipate having around 140 stores integrated with Lana up and running by the end of this quarter and we currently have 4,000 Lana debit accounts with customers [ph] that have to sign up (00:03:25) in on average 3.5 minutes. The app allows customers to digitally view and extend their pawn loans without having to be in the store.

Finally, on the capital management position, we repurchased 142,000 shares in December 2019 and subsequent to that have continued the activity with a total of 415,000 shares now repurchased as of the 3rd of February.

I will now pass it across to Danny for further comments.

Daniel M. Chism

Chief Financial Officer, EZCORP, Inc.

Thanks, Stuart. Good afternoon, everyone. I want to start by providing an update on the share repurchase program the board approved in December of last year. First, we shortened the blackout period from a month to two weeks prior to the quarter-end and we established a 10b5-1 plan prior to the window closing in December which allows the investment bank to repurchase shares on our behalf using predetermined criteria even in blackout periods when we may be in possession of material nonpublic information.

As Stuart mentioned, these actions allowed us to repurchase approximately $1 million of Class A common stock in December. From inception of the program through today, we've now repurchased approximately 415,000 shares for $2.7 million, retiring approximately 0.75% of our outstanding share count. In future periods, we'll report repurchase activity only through the end of the reporting period. But as we just initiated the repurchase program and 10b5-1 plan in December, I wanted to provide a real-time update this quarter.

Stepping back, we remained focused on allocating capital to what we believe will deliver the highest shareholder returns. While we continue to evaluate acquisition opportunities, potential transactions must meet our strict financial and strategic criteria. Coupled with new store development, we continue to see buybacks as an attractive use of capital to deliver return on investment and return capital to our shareholders in a tax-efficient manner.

Looking ahead, we remain well positioned to fund new store development, pawn loan growth and investment spending reflecting the strength of our balance sheet combined with a strong free cash flow generation of the business. To that point, we ended the quarter with $143 million in total cash on hand and the long-term trajectory of cash from operating activities continues to be strong. For the first fiscal quarter of 2020, net cash from operating activities was impacted by reduced payables as we continue to refine working capital management, the payment of year-end bonuses and prepayment of sales taxes to maximize discounts provided by certain states.

In the current quarter, we adopted the new lease accounting standard, also known as ASC Topic 842. While this doesn't change the cash flows related to any of our leases and had no material impact on the income statement, it did require us to record on our balance sheet lease liabilities totaling just over $234 million, mostly offset by a lease right-of-use asset of almost $226 million.

The $8.5 million difference relates to straight-line lease expense recognition which generally causes companies to recognize rent expense sooner than the actual cash flows, so that rent is recognized evenly over the lease terms. Upon adoption of ASC 842, the $8.5 million accumulated difference arising from the straight-line rent recognition was removed from the balance of accounts payable and accrued expenses and reclassified as a reduction of the lease right-of-use asset.

Taking a look at the financial results, on a GAAP basis, EBITDA more than doubled to $15.2 million as we reported diluted earnings per share of $0.02 for the first quarter of fiscal 2020 versus a loss of $0.06 in the prior-year quarter. If you'll recall, I mentioned last quarter that we anticipated recording a $10 million pre-tax charge for our portion of a class action settlement reached by our equity method investee Cash Converters in October. Net of the related tax benefit, this amounted to $7.1 million recorded in our current quarter under equity and net loss of unconsolidated affiliates.

GAAP results also include a $700,000 write-down of costs related to a business intelligence system that we're replacing with better technology and will be more efficient, better supporting data analysis and business insights. GAAP results continue to include noncash interest expense related to our convertible debt and the effects of foreign currency fluctuations which are excluded from our adjusted figures.

And finally, as it relates to taxes, the GAAP effective tax rate for the quarter was skewed by the Cash Converters settlement charge with the related $3 million tax benefit reported in the line item net income from unconsolidated affiliates in accordance with equity method accounting rather than on the income tax provision or benefit line. The current quarter's 32% adjusted tax rate is more reflective of the low- to mid-30% range I continue to expect for the remainder of the year, excluding the Cash Converters charge.

On an adjusted basis, we reported diluted earnings per share of $0.16 for the fiscal first quarter compared to $0.28 this quarter last year. Lana, our digital platform was previously included in our corporate expense, but is now broken out as a separate segment as it begins to produce discrete revenues. As our current year adjusted earnings no longer adjust for Lana, we've recast the prior-year results on a same basis, so they're comparable year-over-year.

While we anticipate Lana will improve our customers overall experience, pawn loan redemption rates and yields by enabling customers to make remote loan extensions and receive communications via mobile device. We don't plan to allocate any incremental pawn service charge revenues to the Lana segment, as doing so would be subjective at best. While the benefits to pawn revenues will remain in the U.S. Pawn segment, we'll report in the Lana segment any discrete Lana revenues and all Lana related expenses.

As shown in the earnings release, the revenue impact in the first quarter of fiscal 2020 was minimal as Lana was introduced to a select number of stores in Florida late in the quarter. Looking ahead, we expect to continue to show a loss throughout this fiscal year for the Lana segment as most of the platform's benefit will be included in U.S. Pawn and discrete revenues will take some time to build volume. Early results in customer adoption have been encouraging, as Stuart mentioned, in the locations where it's been introduced. We'll continue to roll this to additional stores and states as well as beyond our existing customer base as we continue throughout the year.

Turning to the adjusted highlights on slide 5, we produced record-high pawn-related revenues. Total revenues grew 3% year-over-year, reflecting 5% growth in merchandise sales, a 2% increase in scrap sales and a 1% uptick in PSC. Revenues in Latin America were particularly strong, up 13% overall, with an 18% growth in merchandise sales and PSC growth outpacing the increase in PLO with higher pawn loan yields reflecting quality of the loan portfolio.

Similar to what we experienced last quarter, the growth in the Latin America loan balance was below the rapid growth we've seen over the last few years, as the Mexico social welfare programs discussed last quarter continue to suppress loan demand, somewhat offset by higher sales as our customer is more flush with cash. As expected, the pressure seen on merchandise sales margins in both the US and Latin America reflect our continued efforts to optimize overall inventory levels, reduce aged inventory and accelerate the cash-to-cash cycle, increasing free cash flows.

On slide 6, you can see the impact of lower margins, higher corporate expenses, and the drag from new stores with EBITDA margins down in Latin America and on a consolidated basis. While U.S. Pawn EBITDA was down slightly from lower net revenues, the EBITDA margin expanded a bit reflecting effective expense management. As we accelerate new store openings in Latin America, I continue to expect some pressure on short-term EBITDA, EBITDA margins and EPS until those stores ramp.

Typically, new stores in Latin America reach breakeven in 6 to 12 months and reach full ramp in three to five years, at which point, we would expect our EBITDA margins to mirror those at more mature stores. While this pressure short-term earnings, de novo store growth in Latin America continues to represent one of the highest possible returns on invested capital.

Turning now to the consolidated financial highlights on slide 7, ending consolidated pawn loans outstanding, or PLO, was essentially flat year-over-year as growth from acquisitions and new stores was about offset by a modest decline in same-store loan balances. That said, PSC revenues were up despite lower average PLO for the quarter with the year-over-year growth mostly a function of a higher yield, reflecting the quality of the loan portfolio.

Merchandise sales were up 5% from the prior-year quarter with same-store sales growth of 3%. Ongoing efforts to enhance inventory management impacted merchandise margins down approximately 260 basis points year-over-year. On a sequential basis, merchandise margins improved from 33% in the fourth quarter of fiscal 2019 to 34% in the current quarter. Notably, we've successfully reduced aged general merchandise inventory in the United States by 23% year-over-year. Optimizing and fine tuning loan-to-value decisions through the point-of-sale system is expected to drive higher pawn loan yields and sales gross profits over time.

Turning to jewelry scrapping sales, scrap gross profits increased 44% on a 2% increase in sales. Consolidated scrap margins approached 19% in the current quarter compared to 13% in the prior-year quarter, reflecting higher gold prices and a reduction in diamond scrap sales, which are fetching far lower prices than a year ago. Prevailing gold prices remain elevated reflecting investors' general uncertainty regarding the broader market.

On the expense front, operations expenses were well managed 1% favorable to the prior year, despite a 2% increase in total store count. The $4.4 million spike in corporate expense resulted primarily from investments to support the successful implementation of the new point-of-sale system, POS2, and the transition to a new cloud service provider. These efforts resulted in significant improvements in point-of-sale availability, performance and scalability across the US and Mexico.

Corporate expenses also reflect an increase in audit-related services and staff enhancements made since the prior-year quarter to strengthen the IT control environment as well as professional fees related to the adoption of the new lease accounting standard. Both corporate expense and Latin America operations expense reflect some severance costs in the quarter that we would expect to benefit future periods through lower ongoing labor costs.

While discrete revenues in Lana segment remain minimal as its digital platform was just introduced in December 2019, expenses and the segment loss improved to $1.3 million from $2.1 million in the prior-year quarter. The prior year included professional fees related to the initial exploratory work conducted with Boston Consulting Group's Digital Ventures.

Depreciation and amortization of the Lana platform will increase in future quarters as current quarter depreciation only began on the date it was introduced in December 2019. We remain excited about the enhancements this can provide to our customer service and product offerings. We're also pleased to have taken the platform from initial conception to a fully functional digital platform in only a year.

Turning to the U.S. Pawn highlights on slide 8, ending an average pawn loan balances were both essentially flat for the quarter on a year-over-year basis with PSC also relatively unchanged at $64 million for the first quarter of fiscal 2020. Merchandise sales in the US were up 1% year-over-year while related margins softened 220 basis points to 36% given the incremental discounting to move aged merchandise.

Aged general merchandise now stands at 7% of inventory down meaningfully from 9% at this point last year. I expect efforts to reduce aged inventory to continue throughout much of this year. While segment EBITDA was down year-over-year mostly reflecting lower sales margins, operating expenses were well managed in U.S. Pawn, essentially flat to the prior-year period.

Focusing on Latin America on slide 9, financial performance was strong. While ending an average PLO for the quarter was essentially flat with the social welfare programs in Mexico remaining a bit of a headwind, PSC was up 5% compared to the prior-year period on significantly higher yields.

For the fiscal first quarter, the segment generated a monthly yield of 16.1%, up 80 basis points from 15.3% this quarter last year. The improvement includes the impact of POS2 lending guidance designed to take into account not only the value of the loan collateral, but also the likelihood of loan redemptions based on prior experience with the customer. The enhanced lending guidance is not necessarily expected to result in an increase in the overall loan balance, but rather lower amounts loaned to higher risk customers in more generous loans to customers more likely to redeem their loans.

Scrap sales gross profit and related margins were all meaningfully higher versus the year-ago quarter. Further, merchandise sales were up 18% with same-store sales up 16%, though merchandise margins declined 300 basis points year-over-year as we remain focused on adjusting the loan-to-value ratios to optimize inventory and sales gross profits. For the quarter, segment EBITDA was down slightly year-over-year, primarily driven by higher store wages and rent from storefront growth and inflation as well as new licensing requirements and new store drag.

Going forward, while we remain focused on improving oversight and operating efficiencies, we expect some continued pressure on short-term EBITDA margins in Latin America as we accelerate new store openings in fiscal 2020. We've opened 22 new stores since the prior-year quarter, with four of those opened in the most recent quarter and closed one store. We plan to open a total of about 40 new stores in the full fiscal year.

Finally, I wanted to provide an update on financial trends as we move through the year. The social welfare programs in Mexico will likely continue to impact PLO and PSC trajectories in the near-term, while our ongoing efforts to optimize inventory management weigh on short-term merchandise sales margins. That said, we remain focused on growing free cash flow and driving higher returns on earning assets over time.

More specifically, we believe the rollout of our new point-of-sale system will improve lending decisions based on customer-specific history and system lending guidance, driving higher loan redemption rates, yields, PSC and net revenues. And we continue to invest in the business to more fully leverage our technology, distribution, and customer service to enhance long-term growth prospects. This combined with our continuing share buybacks are expected to enhance shareholder returns.

With that, we'll open the call up for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Your first question comes from John Hecht from Jefferies. Your line is open.

John Hecht
Analyst, Jefferies LLC

Q

Thanks guys for taking my question. First, just some I guess basic modeling questions. Danny, you talked about some labor cost saves going forward. So, I'm wondering can you kind of give us a quarterly aspect of the details about what you might save on a quarterly basis.

Second, will the lease expense accounting change, change any of the quarterly lease accruals? And then, you mentioned there's going to be an increase in D&A on Lana, maybe you could quantify that.

Daniel M. Chism
Chief Financial Officer, EZCORP, Inc.

A

Yeah. So, I've not quantified or wouldn't want to put a number on the savings that I expect from some of the severance. I wouldn't factor in a huge change, but would expect some savings going forward, both in the corporate as well as a little bit in the store expense, particularly in Latin America.

On the Lana depreciation, we only had about I think – what, $36,000 or so come through this quarter. We've ended up having about $6.5 million, $7 million of capital put into that last year. Over a five-year term, I'd expect that to be about $1.3 million, $1.4 million per quarter depreciation and that obviously would change if we do further development on that as well, but based on what we've put in there right now.

And then, on the lease costs, I wouldn't expect that to really change the income pattern going forward. That's more an impact on the balance sheet. There'll be a little bit, but that's primarily just grossing up the balance sheet for the asset and liability. And the other, when you look at the accounts payable and accrued liabilities, you'll see also there was – I think I mentioned there was about $8.5 million movement out of that account into the reduction of the right-of-use asset from leases.

John Hecht
Analyst, Jefferies LLC

Q

Okay. That's very helpful. Thanks. And so couple questions, what is – and forgive me if you had it in the presentation or you mentioned it, but do you have handy the same-store PLO in both the US and Latin America?

Daniel M. Chism
Chief Financial Officer, EZCORP, Inc.

A

Yeah. Same-store PLO in the US was down 1% and adjusted in Latin America was – same-store PLO was also down 1%. That was up a bit in GAAP, but constant currency was down a bit.

John Hecht
Analyst, Jefferies LLC

Q

Yeah. Okay. Thank you very much. And then, talking about – and so, it sounds like you're focused on – there's a few moving parts with respect to your margins. One is your focus on reducing aged inventory, but then also some of the ramping up of stores in LatAm and so forth. What do we think about the pace of gross margin this year based on your perspective of getting rid of aged inventory and so forth, when might it bottom or have we already bottomed?

Stuart I. Grimshaw
Chief Executive Officer & Director, EZCORP, Inc.

A

We haven't bottomed yet. It's a mix. I mean we always try to get the margin back to where we indicated we're comfortable, which was the 35% to 38%, but we've got to balance selling the fresh buckets of inventory as well. And if we can balance the fresh buckets with removing the aged, then we will move back towards that ratio. At the moment, we're not moving the fresh buckets as quickly as we like and the real focus of management, both in the US and Mexico, is get a balanced approach to the inventory reduction to maintain the margin as best as we can. But our simple view is we think we've probably got a bit too much inventory which we want to recycle into cash as soon as we can.

John Hecht
Analyst, Jefferies LLC

Q

Okay. And last question is your buyback, I mean, I think your shareholders would think any amount of buyback is good, you guys initiated a little bit of the buyback, but it's still a very small component of the overall, a lot of them out and [ph] it's a rule for quiet period is unfortunate (00:24:22). Should we expect a greater focus and greater usage of that or how do you think about your prioritization of that?

Stuart I. Grimshaw
Chief Executive Officer & Director, EZCORP, Inc.

A

Well, we sort of said we would be doing $20 million a year and we're pretty much on track with where we thought it would be. I mean we are fortunate to get into the market earlier than we thought we would. But we've committed to, subject to anything else coming up, to the $60 million over three years and a pretty much linear pattern on a per annum base.

John Hecht
Analyst, Jefferies LLC

Q

Okay. All right. Thank you, guys.

Stuart I. Grimshaw
Chief Executive Officer & Director, EZCORP, Inc.

A

Thanks, John.

Operator: [Operator Instructions] Your next question comes from Greg Pendy from Sidoti. Your line is open.

Gregory R. Pendy
Analyst, Sidoti & Co. LLC

Q

Hey, guys. Thanks for taking my questions.

Daniel M. Chism
Chief Financial Officer, EZCORP, Inc.

A

Hey, Greg.

Gregory R. Pendy
Analyst, Sidoti & Co. LLC

Q

Just on the aged inventory, I think you said it went from – on a year-over-year basis from 9% to 7%. Can you give us any color on what categories, are we mainly working through electronics or can you just give us a little bit of a breakdown of where I guess the highest portion of the aged inventory is?

Daniel M. Chism
Chief Financial Officer, EZCORP, Inc.

A

Yeah. It's mainly in the electrical area where the technological obsolescence is its highest, particularly the LCDs and the – we have plasmas which I haven't seen for quite a while, but we had a few of those that we actually have liquidated. And we're looking at – through it on a product category basis to actually see where that obsolescence is highest and taking the right price points to move that inventory.

Gregory R. Pendy
Analyst, Sidoti & Co. LLC

Q

Okay. That's helpful. And then, I just – I guess on the buyback, on the changes, Danny, I think you mentioned it went from sort of a blackout period of a month window to two weeks. Is it 48 hours...

Daniel M. Chism
Chief Financial Officer, EZCORP, Inc.

A

Correct.

Gregory R. Pendy
Analyst, Sidoti & Co. LLC

Q

Is it 48 hours after reporting still?

Daniel M. Chism
Chief Financial Officer, EZCORP, Inc.

A

So, for the window to officially open, it would be – although, we're still under the 10b5-1 trading plan that we put in place in December. So, we're still under that plan, assuming it hits the parameters we set up within that, we could still be in the market purchasing currently.

Gregory R. Pendy
Analyst, Sidoti & Co. LLC

Q

Okay. Very helpful. Thank you.

Daniel M. Chism
Chief Financial Officer, EZCORP, Inc.

A

Thanks, Greg.

Operator: There are no further questions at this time. I'd like to turn the call back over to Stuart Grimshaw for closing remarks.

Stuart I. Grimshaw
Chief Executive Officer & Director, EZCORP, Inc.

Thanks very much and thanks everyone for tuning in. We'll be around to obviously answer the questions over the next couple of days and we look forward to those conversations. Thanks once again.

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.