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EZCORP, Inc. (EZPW)

Q1 2021 Earnings Call

CORPORATE PARTICIPANTS

Jason A. Kulas

Chief Executive Officer & Director, EZCORP, Inc.

Tim Jugmans

Interim Chief Financial Officer, EZCORP, Inc.

OTHER PARTICIPANTS

Gregory Pendy

Analyst, Sidoti & Co. LLC

John Hecht

Analyst, Jefferies LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and welcome to EZCORP's First Quarter Fiscal 2021 Earnings Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer and instructions will follow at that time. As a reminder, this call may be recorded.

I would now like to turn this conference over to Mr. [ph] Michael Keim (00:25), Investor Relations. Please go ahead, [ph] Michael (00:28). You may begin.

Unverified Participant

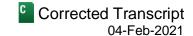
Thank you and good morning, everyone. During our prepared remarks, we will be referring to slides which are available for viewing or download from our website at investors.ezcorp.com. Before we begin, I'd like to remind everyone that this conference call, as well as the presentation slides, contains 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. Jason Kulas. Jason?

Jason A. Kulas

Chief Executive Officer & Director, EZCORP, Inc.

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Thanks, [ph] Michael (01:43), and good morning, everyone. I want to start by thanking our team members for their ongoing efforts and dedication. We remain focused on the health, safety, development, and retention of our team members through and beyond the pandemic, with the goal of building the most effective and seasoned workforce in the industry. And it is because of this outstanding team that we were able to make the progress we are making toward our goals.

I also want to thank our customers for their trust and loyalty through the pandemic. We remain committed to strengthening and growing our core pawn business to address our customers' needs for cash and affordable preowned merchandise. Virtually all of our stores remain open, with ongoing initiatives to extend payment options, enhance our digital pawn servicing platform to broaden customer engagement, and increasingly leverage technology and data analytics across geographies to optimize lending and retail pricing.

So starting on slide 4 of the investor presentation, the first key financial theme for the quarter was strong and consistent growth and demand for pawn loans. Even our store expenses remained flat quarter-over-quarter. Pawn loans outstanding or PLO ended the quarter at \$148 million, up 11% on a sequential quarter basis, primarily driven by ongoing efforts to enhance our value proposition to customers and a fading impact from prior government stimulus programs.

Having said that, the recently implemented second stimulus package reduced demand for pawn loans in early January before stabilizing in the second half of January. The upcoming tax refund season will further and temporarily curb loan demand, and therefore, PSC in the near term. Once we get through tax season and incremental stimulus programs run their course, we expect PLO, and ultimately, pawn service charges to pick up as they did in the first guarter and lead to a return to pre-COVID levels.

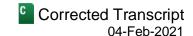
Second, the revenue backdrop remains challenging during the first quarter, as well as through January, with pawn service charges and merchandise sales depressed relative to prior year levels, as we continue to work through rebuilding PLO. As a result, adjusted EBITDA and EPS were down year-over-year, with further pressure likely to come in fiscal 2021.

Third, while lower inventory levels resulting from declining pawn loans and forfeitures are constraining sales to some degree, merchandise sales gross profits trended higher, reflecting accelerating inventory turnover and higher margins. For the first quarter of fiscal 2021, our inventory turnover ratio reached 2.9 times compared to 2 times for the year-ago quarter. We also continue to make progress on more effectively managing our inventory. To the point, in aggregate, aged general merchandise inventories stood at \$2.1 million or 5.2% of total inventory at the end of December 2020, down from \$7.4 million or 7.2% of total inventory a year ago.

Fourth, in the first quarter, we identified and realized incremental cost savings above what we implemented and communicated in the prior quarter, which we will discuss in greater detail later, and remain on track to meaningfully improve operating efficiencies as a result of our strategic expense reduction initiatives. Looking ahead, while store level operating costs will trend higher as transaction activity rebuilds, ongoing cost reduction and simplification efforts across the business positioned us well to drive outsized operating leverage as assets and revenues rise, thereby driving a step-up in earnings power over time.

And finally, our balance sheet remains strong, with \$290 million of cash on hand at quarter-end at no near-term debt maturities, providing us with the liquidity and flexibility to continue to fund accelerating PLO growth, de novo store openings, and potential M&A opportunities, should they arise, with an ongoing emphasis on generating strong returns on capital.

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We believe slide 5 illustrates at a high level how we think about continuing to strengthen and grow our core business. Each of the pieces is critical, starting with the strength of our team members, their passion for pawn broking, and our focus on customer service. That foundation enables us to drive key strategic initiatives focused on strengthening the core, reducing and simplifying our cost structure, and continuing to innovate and grow. And as reinforced by several key performance indicators this quarter, ongoing execution against our plan will drive sustained growth, financial results, and shareholder value. The key message on slide 5 is that each piece of the puzzle is critical.

We will now go into some additional detail on several of these. Turning to slide 6, we want to provide an update on our cost reduction and simplification efforts. As you may recall on last quarter's conference call, we laid out plans to streamline expenses to better align with the near-term PSC trajectory and maximize profitability when revenue growth resumes, at the time we identified and realized approximately \$12 million of recurring annual savings, mostly related to G&A. With further work in the quarter, we have raised that to \$13 million, and we look forward to continuing to report on our progress in future quarters.

Turning to store costs, while PLO increased 11% quarter-over-quarter, we achieved incremental store expense savings during the quarter, which are down over \$9 million compared to last year. This has been achieved through improving efficiencies of all levels and leveraging a lower store staffing model. While we will continue to increase productivity, we anticipate adding additional expenses in a cost effective manner as transactional demand increases.

Stepping back, it's important to reiterate that we will remain focused on extracting further operating efficiencies in fiscal 2021 and beyond, with ongoing plans to simplify and centralize corporate functions, standardize back office and store processes, rationalize data and recording, and automate corporate and store-level practices.

Next, on slide 7, we frame ongoing initiatives to strengthen our core pawn business. From a people perspective, we remain focused on enhancing career development programs and succession planning to promote a passion for pawn broking and to improve engagement and retention. In fact, annualized turnover for hourly team members here in the US declined by 24% and Mexico declined by 14% in the first quarter of fiscal 2021.

On the technology side, we continued to leverage our next-generation point-of-sale system to automate product pricing, increase transaction speed, and improve pricing accuracy. We continue to optimize lending values and introduce new products and services in a deliberate manner, and we are increasingly adopting business intelligence and customer analytics to improve performance measurement.

Turning to our innovation and growth initiatives on slide 8, as we discussed last quarter, we continue to reposition Lana as our digital pawn channel, and we are seeing encouraging results. The number of online extension transactions through lana.com doubled on a sequential quarter basis, while the amount of PSC collected was up 3x compared to the fourth quarter of fiscal 2020. In addition, we introduced layaway payment options in select stores in the first quarter, with plans to broaden participation across all US stores in the next few months.

Second, improving customer service remains a top priority. Related ongoing initiatives include the development of online account management and enhancing central customer support capabilities.

Next, we remain focused on increasingly leveraging digital to drive client acquisition. We are in the process of developing a comprehensive digital marketing strategy, with an initial focus on search engine optimization and social media. And from a process standpoint, we've implemented a disciplined test-and-learn approach to control marketing spend and maximize return on investment.

Finally, in terms of store growth, we continue to take a measured approach to de novo openings in light of ongoing macroeconomic uncertainty, primarily related to the pandemic, and to maximize liquidity to fund PLO growth and any new potential acquisition opportunities across core markets that meet our strategic and financial criteria.

Our pawn operations play an essential role in meeting the short-term cash needs of our clients, both here in the US and across Latin America, while our complementary retail business facilitate the recycling of pre-owned goods. And while we've made significant progress in optimizing our core pawn business, we remain focused on continually improving all aspects of our operations in order to position EZCORP to drive earnings power and shareholder value over time.

So with that, I'd like to turn the call over to Tim Jugmans, our Interim Chief Financial Officer. Tim?

Tim Jugmans

Interim Chief Financial Officer, EZCORP, Inc.

Thanks, Jason. For the first quarter of fiscal 2021, we reported diluted earnings per share of \$0.08 for the quarter on a GAAP basis, compared to \$0.02 for the prior fiscal year's first quarter, which included a \$7.1 million CCV settlement charge. On an adjusted basis, diluted earnings per share was \$0.13 for the fiscal first quarter compared to \$0.17 in the prior year quarter. Importantly, adjustments for the quarter were mostly related to our standard practice of adding back non-cash interest expense related to our convertible debt.

Focusing on our consolidated financial results for the first quarter on slide 9, PLO ended the period at \$149 million, an increase of \$15 million since the end of September 2020 and up \$33 million since the end of June 2020. On a year-over-year basis, PLO is down 24%, driving lower PSC revenue for the quarter. This was an improvement sequentially from being down by 33% at the end of September and down 39% at the end of June.

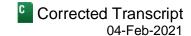
Merchandise sales are down 14% year-over-year, largely reflecting low inventory levels, mostly a function of higher turnover. That said, merchandise sales gross profit is up 2% on more favorable profitability. Merchandise sales gross margins expanded by 640 basis points from the prior year quarter, primarily driven by reduced aged inventory levels and higher velocity, particularly in the 0 to 90-day age bracket. Putting it altogether, consolidated EBITDA was down 24% compared to the first quarter of the prior fiscal year, with softer PSC revenue, partially offset by lower store and G&A expenses.

Turning to our US pawn operations on slide 10, segment PLO continued to improve on a sequential basis and it was up 15% versus last quarter. However, on a year-over-year basis, PLO is down 21%. This led to a 22% decline in PSC, driven by lower average PLO for the quarter, partially offset by year-over-year improvement in PLO yield due to our continued refinement and execution of our systemic lending guidelines and focus on our customer.

On the retail side of the business, merchandise sales decreased 14% compared to the first quarter of fiscal 2020. More favorably, the US segment's merchandise sales gross margin expanded by 590 basis points versus the prior year quarter. This is a result of the change to our pawn operating model, which focuses on selling fresh inventory and reducing aged.

Consistent with more recent trends, aged general merchandise inventory continued to decline, and now stands at \$1 million or just 3.4% of general merchandise inventory, versus \$4.9 million or nearly 7% of the total a year ago. From a bottom line perspective, we remain focused on identifying and realizing further expense synergies. In fact,

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store expenses were down 9% year-over-year. However, US pawn EBITDA was down 25% compared to the prior year quarter, mostly a function of lower pawn service charges.

Slide 11 walks through our financial results in Latin America. While PLO and PSC trends improved on a sequential basis, year-over-year comps were more challenging. More specifically, pawn loans outstanding declined 33% compared to a year ago, largely reflecting ongoing COVID-19-related headwinds, including operating restrictions and transportation limitations across select regions. Following through, PSC was down 32%, as lower average PLO for the quarter was offset by a more favorable PLO yield due to a higher redemption rate.

Merchandise sales declined 15% versus the prior year quarter, but the segment's merchandise sales gross margin expanded by 770 basis points, driven by increased velocity, with inventory turnover up 41% to 3.8. And we remain focused on continuing to optimize LTVs and inventory management. Finally, EBITDA was down 35% year-over-year to \$6.2 million on lower PSC, what was up from around breakeven last quarter, driven by ongoing expense reduction efforts.

Turning to our forward outlook, PLO balances here in the US softened in the first half of January, following incremental stimulus payments, and we expect further pressure on pawn loan demand, assuming further government programs and as we work through tax refund season. Recent trends suggest a more muted PLO impact related to incremental stimulus versus prior government actions, and we fully expect demand trends to normalize over time.

Last quarter, we highlighted the natural lag that exists in the pawn business between new loan growth and the ultimate revenue impact, whether it be in the form of pawn service charges or related merchandise sales, assuming the underlying collateral drops to inventory. Furthermore, despite accelerating turnover and velocity, lower inventory levels remain a near-term headwind for merchandise sales on an absolute basis. More favorably, ongoing expense management efforts remain key offsets and set up us well for a step-up in earnings power as revenue rebuilds over time.

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

QUESTION AND ANSWER SECTION

Operator: At this time, we will be conducting a question-and-answer session. [Operator Instructions] Our first question comes from the line of Greg Pendy with Sidoti. You may proceed with your question.

Gregory Pendy

Analyst, Sidoti & Co. LLC

Hey, guys. Thanks for taking my questions. Can you just help us understand, I guess, the challenges to maybe getting inventory to a normalized level, and just where that level or how we should think about it might be? Because it seems like you've swung maybe to a little bit high on the inventory levels to now lean. And when you think about us going into tax refund season and another round of stimulus, it would seem that you might be missing sales.

Jason A. Kulas

Chief Executive Officer & Director, EZCORP, Inc.

Sure, Greg. Thanks for the question. So, the biggest driver of inventory is going to be our PLO, our loans. And with the loan balance being down, we have less dropping out of loans into inventory. We do purchase items as well. But the biggest driver by far is our loan book.

One thing that's interesting is if you look at the ratio of inventory to PLO, we really feel like where we are today is much more in line, a little bit low. Obviously, it'll continue to be a little bit higher, but much more in line with, I think, where we'd like to be going forward. I think right now, the inventory to PLO, for example, in the US is around that 0.64 range. And the right level is a little bit higher than that, but still lower than what we've been historically. A year ago, we were closer to 1:1 in the inventory to PLO.

I think the really interesting point that you made about coming into this season where sales would typically pick up and having lower inventory going into that is that we do still have inventory. We also have seen, and I guess some encouraging signs in this current environment, is that we've had strong sales with less inventory. So, we've managed that inventory, that we do have better. We've got higher inventory turns, we've got greater velocity in that 0 to 90-day kind of those early buckets, we've got less aged inventory. So, the overall picture in terms of how we're managing inventory is really positive. We'd like to have more, and as we make more loans, that'll generate more inventory. And the good news is as we get that inventory, we feel like operationally, we're in a position to manage it much better than we have in the past.

Gregory Pendy

Analyst, Sidoti & Co. LLC

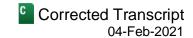
Okay. And then, maybe just a follow-up on that, just given your inventory is improved and where you're kind of thinking on aged inventory, historically, you guys usually targeted, and I might be wrong, but a gross margin – I should say, merchandise margin range, I believe it was in the 35% to 38% range. Any thoughts on whether that'll be kind of tracking, as we saw in this quarter, towards the high end over the next couple of quarters?

Jason A. Kulas

Chief Executive Officer & Director, EZCORP, Inc.

It's definitely above that range right now. We still think of it as a long-term 35% to 38%, although much more likely to be at the high end of that range, given some of the factors that I just mentioned in terms of how we're managing

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it better. So, I think we'll settle into a level that's likely a little bit lower than we are, but higher than we've been historically because of those operational improvements.

Gregory Pendy

Analyst, Sidoti & Co. LLC

Okay. Great. And then, just one final one, I mean, you mentioned, I guess, on the call just a more muted impact, and there's been discussions of another, I guess, a \$1,400 stimulus round coming in back. Can you just give us a little bit of color on the puts and takes on why we might – you're starting to see a more muted impact in the existing PLO balance from the stimulus checks?

Jason A. Kulas

Chief Executive Officer & Director, EZCORP, Inc.

Yes. So, that is very encouraging. If you look at the impact to the loan balances of what started to come through in very early January, we did see a little bit of a pullback, but since mid-January, we've seen that stabilize and not continue to drop. We will see a drop if there's another round of stimulus and it's as large as what's being discussed.

I think what's really encouraging for us is what we saw in this last – in this second round is that it is lower, the impact is lower to the book than it was the first time around. A lot of people that might have taken those stimulus dollars and used them to pay down pawn loans maybe already did that and have not yet come back. But probably, the most encouraging sign that we see is that – and we saw this in our – in this last quarter, our fiscal first quarter, is that PLO grows when stimulus fades. We've seen it. And we've been saying that's what happens, but it was great to see it. And so that we know as we look forward and we get past tax season in whatever form that takes, and we get past this next round of stimulus, the demand comes back and it comes back quickly.

Gregory Pendy

Analyst, Sidoti & Co. LLC

That's very helpful. Thanks a lot.

Jason A. Kulas

Chief Executive Officer & Director, EZCORP, Inc.

Absolutely. Thank you.

Operator: Our next question comes from the line of John Hecht with Jefferies. You may proceed with your question.

John Hecht

Analyst, Jefferies LLC

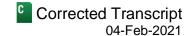
Yeah. Thanks, guys, very much and good morning. Real quick follow-up in the margins, I guess the only question I have on that, other than what was asked, is – was there anything tied to [ph] aiming (22:51) the mix? Was there any particular product category that had much better margin flow than the other categories? And what's the mix of those products right now as we sit here?

Jason A. Kulas

Chief Executive Officer & Director, EZCORP, Inc.

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Yeah. So thanks, John. This overall – this better approach to inventory management is all boats are rising with that. So, that's been really positive. Obviously, with some of the moves you've seen in commodity prices, the margins in gold have been good for us. Also, the increase in gold prices has allowed us to lend more on each individual piece, which has benefited the business.

In terms of where we are in margins versus where we were in different categories, again, we've kind of seen improvement across the board. When you look at what happened early on, there were certain items that where demand was really strong really quick in terms of things that people needed to be at home and be sheltered in place and those kinds of things, TVs, game consoles, those kinds of items. But again, we're seeing improvement across the board. And if you look at where we were a year ago in terms of those margins, we've seen a substantial amount of improvement across the whole business, but also in each piece of the business, big improvement in the US, even greater improvement in Latin America. And as the business scales and we continue to manage it effectively in that way, we think we'll see a big step up. But hopefully, that's helpful guidance, but again, we've seen improvement across the board.

John Hecht

Analyst, Jefferies LLC

Okay. No, that's – that is very helpful. And then, obviously, you guys have done a great job controlling expenses, and you talked about investing in expenses as the business regrows. So, should we just think about the kind of base level of expenses this quarter as a starting point and grow slowly with the recovery of the business, or any other factors to think about with respect to internal investments and so forth in the cadence to those?

Jason A. Kulas

Chief Executive Officer & Director, EZCORP, Inc.

Yeah. John, I think that is – what you said is exactly how we view it. If you compare this coming quarter, for example, with the quarter we just closed, it's probably a good base to think about it, with maybe a slight increase related to an increase in activity. As we see – one of the impacts of more dollars coming in that people would potentially use to pay down loans since there's more activity in the stores, and you do need staffing and labor in those kinds of things to handle that increase in activity. So, we would expect a slight increase quarter-over-quarter, but I think the way you said it is the right approach.

John Hecht

Analyst, Jefferies LLC

Okay. Thank you. And then, I guess maybe update on Lana and the investment in the infrastructure there. I guess where are we in this process, what kind of positive effects are you seeing, and what are the kind of near-term goals with respect to developments in that strategy?

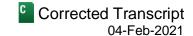
Jason A. Kulas

Chief Executive Officer & Director, EZCORP, Inc.

Yeah. So, we're pretty excited with what we're seeing with Lana right now. It's – in terms of volumes, we made a few comments in our prepared remarks. But if you look at just where we were over the summer versus where we are now in terms of the number of extensions being done on Lana, we're doing – I think we're in that kind of 10,000 extensions range from a much lower level, maybe a five times increase from where we were in the summer.

PSC, this is growing off of a small base, but our PSC collection since the summer are up about 12 times. If you look at overall, the percentage of our total extensions there being made to the Lana platform now, I think it's in

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that kind of 7% to 8% range of our total extensions are being done through Lana. So, we've seen a really big pickup in activity, and we think that is just our customers saying we do need that convenience from time-to-time to be able to do an extension from work or from home on days when we can't get into the store. And so, that's been really good.

In terms of investment, our – the spend on Lana to maintain the platform is much lower than what it was to grow the platform. At the same time, though, we are making continued investments because we do want to continue to roll out additional functionalities. So, we mentioned layaways. That's been tested. And now, over the next few months, it'll be rolled out to all stores in the US. And it's just another one of those functionalities that's nice if you're making those regular layaway payments to be able to do it from anywhere, instead of having to come into the store every time you do it.

So, we will continue to report on those volumes. And what's likely as it continues to grow is that the rate of growth will slow, but it's already established itself as our digital pawn servicing platform and something that our customers do appreciate having.

John Hecht

Analyst, Jefferies LLC

Okay. Appreciate the color. Thanks very much.

Jason A. Kulas Chief Executive Officer & Director, EZCORP, Inc.

Yeah. Thanks, John.

Operator: Ladies and gentlemen, we have reached the end of today's question-and-answer session. I would like to turn this call back over to Mr. Jason Kulas for closing remarks.

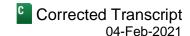
Jason A. Kulas

Chief Executive Officer & Director, EZCORP, Inc.

So in closing, thank you, everyone, for your time this morning. We look forward to continuing to discuss our progress on future calls, and we hope everyone has a great day.

Operator: Thank you for joining us today. This concludes today's conference. You may disconnect your lines at this time.

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