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EZCORP, Inc. (EZPW)

Q2 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon, ladies and gentlemen, and welcome to the EZCORP Second 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 would 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 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 would 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 morning, everyone. As we do this presentation remotely, it reminds us that we are on unprecedented territory. I hope that all of you and your families are safe and healthy. These are difficult times for our people, our customers, the communities we are in, and for all of us as we try to understand and manage the impacts of the COVID-19 pandemic. I would like to express my deepest anticipation to the healthcare professionals, first responders, and other essential workers who are doing their job every day to keep all of us safe. I would also like to thank the members of the EZCORP family who've responded to this crisis with admirable professionalism empathy, providing unbelievable service to our customers in the most trying of times. Since mid-March, the focus of the company has been on serving and supporting our people and customers as they try to make sense of this very unsettling period. We provide critical and unique services to our customers and our operations are considered essential services in nearly all states.

At this time, we have 99% of our stores open in the US and Mexico with many of our LatAm stores operating under reduced hours, restricted operating activities, or environments with no or limited public transportation. All stores are adhering to the CDC sanitary guidelines including provision of gloves and masks, as well as all the US stores having thermal thermometers for the safety of our team members and customers.

With an unemployment rate just hitting under 15%, probably completely unimaginable some three months ago we know that our customers are facing challenging times. It is through these challenging times that we're here to help them when other institutions will not. As shown on slide 4, we're committed to maintaining the well-being of our workforce through this crisis with no layoffs. Our store turnover is down 8% in the US and 4% in Latin America. Additionally, we have implemented remote work options, social distancing measures, and stringent cleaning procedures in all of our stores. We are providing our customers with more choices by introducing innovative and flexible measures to support transactions including curbside Pawn capabilities, accelerating the rollout of our Lana platform to provide remote loan management options for our customers.

We now have Lana operational in 357 stores which at the end of March were 159. The addition of curbside Pawn and Lana has helped us maintain a high level of service and safety for our customers at a time when the ability to service them efficiently has been necessarily restrictive. We entered the process in a position of financial stability with sound liquidity and a strong balance sheet. In the midst of uncertainty and volatility, we've been taking appropriate actions to preserve and enhance our liquidity and position ourselves positively through this crisis.

Our cash position is at unprecedented levels with greater than $250 million of cash, no near-term debt charities, and no restrictive debt covenants. In addition, we continue to produce steady free cash flow while also assisting customers who do need cash support through this period of time. We continually review all expenses including the identification of approximately $7 million in savings expected from CapEx this fiscal year, incorporating a slowing into mobile openings in LatAm to 25 from the original 40 anticipated. We expect this de novo program to ramp up once the economy start reopening. Turning to our share repurchase program, we temporarily suspended buybacks in the quarter to maximize liquidity for anticipated future loan demand.

Once the virus impact is completely neutralized, the board will reconsider the share repurchase program as part of our broader capital allocation strategy. Turning to slide 5, we are pleased with our strong financial performance for the fiscal second quarter even as our results and focus were impacted in the last few weeks of March as the COVID-19 crisis developed. However, one of the unintended consequences of operating in this pandemic-driven environment has been the impact of accounting standards in these unprecedented economic times.

In the second fiscal quarter, we were required to record a non-cash asset impairment charge of $47.1 million primarily related to the impairment of goodwill in both the US and LatAm, reflecting the potential long-term financial impact of COVID-19 related store closures, coupled with PLO balance reductions as a result of excess cash in the hands of our customers being applied to early loan repayments.

While a majority of our stores have remained open, a good portion of the stores with GP mix have been closed since March but this is where the bulk of the goodwill impairment is recognized. Once the noise for the non-cash impairment expense is removed, our adjusted results for the fiscal second quarter reinforce the strength and resiliency of our business. Revenues and EBITDA were healthy, driven by solid sales, coupled with tight control of expenses. Adjusted EBITDA was up 14% year-on-year with total revenue for the quarter up 5%.

Focusing on our core US Pawn operations, merchandise sales and sales gross profit were [indiscernible] (06:06) the year-over-year, driving strong free cash flow for the quarter with the majority of free corporate expense cash flow generated from the US. Post-quarter-end, retail sales demand has remained strong in the US and Latin America and continues to drive the business with stimulus deposits and checks have begun to be distributed. While retail sales demand has increased, the offsetting impacts has been around diminished Pawn loan demand, exacerbated by accelerated Pawn loan repayments.

Turning to page 6, I won't spend too much of time on this slide as I am sure you're well aware of the macroeconomic backdrop. But the key message here is that the financial health of the US consumer is increasingly coming under pressure which we believe will drive increase needs of non-bank sources of cash in the future.

On slide 7, we outlined out taxing approach to growth. Stability and liquidity remained key hallmarks of our business not just from the financial perspective but also as it relates to our key systems, employee retention and culture and expense management across the company. Ours is a recession resilient business and we are well-positioned to regain loan momentum during a more challenged macroeconomic backdrop with a majority of stores open and the conservative and liquid balance sheet to serve our customers as loan demand increases.

Flexibility across platforms, products, and payment option remains another key differentiating factor as we'll discuss next. Turning to how we continue to expand our presence, we remain committed to opening new stores and are well-positioned to capitalize some opportunistic acquisitions to complement organic revenue growth and accelerating demand for loans post-stimulus with an ongoing focus on driving higher returns on earning assets over time.

Next on slide 8, we wanted to provide some additional context on how we increase the leveraging innovative systems, platforms, and approaches to enhance customer choice and growth. Starting with Lana, you may recall that we expected to roll out the Lana platform to 140 stores by the end of Q2. We've accelerated the rollout with 357 stores currently on the platform and over 8,000 customers signed up at the end of Q2. As of the end of April, that number has moved to 14,000 customers. Also in April, we processed over 4,600 Pawn loan extensions on the system, around 2.8 times the number in number of March.

Lana further enhances the customer experience by delivering greater flexibility in communications and we plan to increasingly leverage our differentiated digital engagement initiatives moving ahead. In fact, on social media, we've engaged more than 600,000 consumers in four weeks, promoting open stores in major cities and a curbside offering.

Beyond digital and in response to COVID-19, we recently implemented curbside pawn capabilities to continue to meet our customers' needs within social distancing parameters and from the comfort and safety of their vehicle.

Curbside labeling services include new loans, extension payments, loan renewals, loan redemptions, merchandise sales, and new layaways and layaway payments.

From our first pilot store in April 1, we've launched curbside services in over 60 stores in April to maintain store operations and improve customer convenience which we believe will deliver the longer-term benefits around customer loyalty and retention. Lastly we remain focused on a multi-channel approach to payments spanning Lana, curbside pawn, cross-store payment capabilities and debit by phone options for the convenience of our customers which should support redemption rates in PSC yields going forward.

So in summary, our business remains well-positioned to navigate through this crisis. While the future remains difficult to predict, we believe that a more challenging economic backdrop will accelerate demand for Pawn loans at the time.

Furthermore, we are increasing leveraging at differentiated point of sales system to drive optimized lending decisions and margin improvements in [ph] newer entry (09:44) buckets and it give us the flexibility to introduce new products and services. However in medium term we will continue to focus on the health and safety of both our employees and our customers and develop new and innovative ways to satisfy our customers' need.

Finally, we are very excited to bring on board Jason Kulas as President and Chief Financial Officer. Jason was a member of the EZCORP board since April of 2019 and brings with him a deep background in customer finance.

With that, I'll now pass over to Jason for further comments.

Jason A. Kulas

President & Chief Financial Officer, EZCORP, Inc.

Thanks, Stuart. Good afternoon, everyone. Just to start, I'm very excited to join the EZCORP team, and I'm looking forward to continuing to work with Stuart and the team to drive the company forward.

To begin, as Stuart mentioned, we recorded a non-cash pre-tax impairment charge of $47.1 million or $0.85 per diluted share in our fiscal second quarter. These primarily related to impairment of goodwill in our US Pawn and Latin America reporting units. While the bulk of our stores have remained open, many of the stores in our GPMX countries have been closed. Prior to the store closures in March, the GPMX business was performing well with profits before tax ahead of plan.

As Michael mentioned in the introduction, results in this discussion are presented on an adjusted basis so the impact of the non-cash impairment charge is added back in order to better reflect our core operating performance in the quarter.

Before getting into more detail on the financial results, I wanted to provide a bit of context on how the quarter played out in light of the COVID-19 pandemic and how we're positioned going forward. Retail sales have remained strong throughout our fiscal second quarter, offsetting a delay in demand for Pawn loans that continued into April, largely reflecting the impact of tax refund season followed by the uncertainty of the current crisis and eventually by the distribution of the first stimulus checks. You can see this reflected in the ending PLO down 5% year-over-year.

In April, the decline in PLO continued with US Pawn PLO down approximately 30% versus April 2019 and Latin America PLO down just under 20% on a constant currency basis. We expect to see accelerating loan demand post the stimulus, and in April, retail sales volumes have continued to be strong and provide a meaningful offset to the current drop in loan demand.

Turning to expenses. We've stepped up our focus on streamlining and optimizing resources across to our operations and at the corporate level and are in the process of negotiating agreements with suppliers. All processes across the company being reviewed with the goals of improving the time required to make a new pawn load, expanding payment options for customers, and optimizing the valuation of collateral. And as Stuart mentioned earlier, our balance sheet continues to strengthen, and we are ready for a pickup in loan demand. We have a growing cash balance positioning us to serve our customers' loan needs, as well as capitalize on potential opportunistic acquisitions.

Our cash balance in late April is greater than $250 million which is over $100 million greater than the $143 million we had at the end of December. As we run stress testing scenarios on the business, we are confident that we can run our business effectively in a number of different environments while maintaining a strong balance sheet. And finally, the debt structure of our balance sheet is an advantage for us with no near-term debt maturities or covenants restricting our operations.

Looking ahead, while lower end of quarter loan balances will pressure PSC revenue in the short term, we expect loan demand to return post-stimulus. In the meantime, we continue to see higher merchandise sales and gross profits, and we are seeing early returns in the US from our efforts to manage inventory and optimize operations.

Now turning to our financial results for the quarter. On a GAAP basis, we reported diluted earnings per share of negative $0.74, a decrease of $0.80 from the prior year, driven by impairments to goodwill in our US Pawn and Latin America reporting units previously mentioned. In addition to adding back the impairment, we added back our typical exclusion of non-cash interest expense related to our convertible debt and other adjustments related to minor write-offs, FX fluctuations, and other discrete items totaling just $1 million in aggregate on a pre-tax basis. On an adjusted basis, we reported diluted earnings per share of $0.17 for the fiscal second quarter, compared to $0.19 in the prior-year quarter.

Focusing on our consolidated financial highlights on slide 10, total revenue was up 5% driven by retail demand that has continued post-quarter-end with government stimulus actions. Secondarily, the influx of cash drove with healthy pawn service charges as loans were redeemed, driving a 5% reduction in pawn loans outstanding for the quarter. Merchandise sales grew 8% on a year-over-year basis with same-store sales growth of 6%, and it remains strong in April. Sales gross profits were up 2% as we increased inventory turns and reduced aged inventory. Consistent with prior quarters, our efforts to optimize cash-to-cash cycles and inventory management continue to pressure related margins. At 34%, our merchandise sales margin was flat on a sequential quarter basis but was down about 200 basis points compared to the fiscal second quarter of 2019.

Newer buckets are coming in stronger and showing early returns from our efforts to optimize the business. On the expense front, operating expenses were down 1% year-over-year despite a 3% increase in total store count while corporate costs were held in check as a result of expense control measures. Importantly, we've reduced non-store based expenses by 16%. As a result, adjusted EBITDA grew 14% to $26.1 million for fiscal second quarter 2020 and our EBITDA margin expanded by 240 basis points to north of 20% for the quarter in spite of the March impact of COVID-19.

Coming to the US Pawn highlights on slide 11. Total revenue was up 5%, reflecting 7% growth in merchandise sales while EBITDA was up 5% year-over-year with the related margin expanding by approximately 110 basis points to 32.9%.

While ending PLO was down 7% on a year-over-year basis with quarter-end PLO per store of 238,000, the average loan balance was down less than 2% with most of the point-to-point decline coming late in the quarter as a result of early COVID-19 related impacts.

As mentioned earlier, our enhanced point-of-sale system is increasingly improving loan-to-value decisions on the front end and in turn driving the higher pawn loan redemption rates and yields. To the point PSC remained essentially unchanged at $62 million for the second quarter of fiscal 2020 with yields up 70 basis points from the prior-year quarter. Again, merchandise sales in the US were up 7% year-over-year for fiscal second quarter 2020 and sales growth remained strong in April up approximately 50% over April 2019.

Sales margins softened in March by 70 basis points to 36% given ongoing progress in moving aged merchandise. These efforts have been effective with aged general merchandise inventory down 10% to 6.5% of total inventory from 7.2% last year. In addition, as strong sales have continued into April, we've seen a further drop in our aged inventory to just over 5%, a drop of roughly 20% since the end of March.

Jewelry scrap and gross profit increased 38% with related margins up 220 basis points to 19.2% on higher gold prices. Focusing on Latin America on slide 12, both ending and average PLO for the quarter were up 1% with same-store loan balances down 0.5% largely reflecting recently introduced social welfare programs in Mexico, as well as the impact of COVID-19-driven redemption activity. PSC was flat compared to the prior-year period with a higher average PLO balance offset by a lower yield for the quarter. While stores in Mexico have remained open, activity at GPMX has been impacted by store closures. Merchandise sales remained strong, growing 14% versus the prior-year quarter with same-store sales up 7%.

Sales volumes remained strong in April with sales in Mexico up over 15% versus April 2019. Merchandise margins declined 600 basis points year-over-year as we remain focused on optimizing LTVs to drive long-term inventory yield improvement. Notably inventory turns increased from 2.3 times in the prior-year quarter to 2.5 times for the fiscal second quarter of 2020. Segment EBITDA was down 13% year-over-year primarily driven by lower merchandise gross profit and higher operating expenses which related growth just above the inflation rate.

Going forward in Latin America, while we remain focused on realizing incremental efficiencies, near-term margins likely remain somewhat depressed as de novo stores continue to ramp up and mature. In addition to maintaining financial flexibility to fund the expected increase in demand for loans investing in new stores remains a key high return growth driver, and we plan to open approximately 25 new stores in Latin America this fiscal year.

Beyond de novo growth, the team continues to be positioned for opportunistic acquisitions should they arise. In summary in our fiscal second quarter, we've reacted quickly to keep our team members and customers safe. We've introduced innovations in the way we serve our customers that will last well beyond the current crisis. This flexibility is allowing us to engage our customers in new ways. Our geographic diversity is proving to be a strength as a large percentage of our cash flows are coming from our US-based stores. We've added to our strong balance sheet and maintain a cash balance that will allow us to operate effectively and grow over time in all scenarios and our systems are starting to become the differentiator we expected them to be.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question comes from the line of Greg Pendy from Sidoti & Company. Your line is open.

Gregory Pendy
Analyst, Sidoti & Co. LLC

Q

My question, just real quick, how should we think about the rise in gold prices because it would look like customers maybe choosing to just outright sell over pawn in order to take advantage of the prices? So do you think that's a positive or somewhat a negative that gold prices have risen?

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

A

Thanks Greg. I'll take it. It's Stuart. Good morning. We 're not seeing as much gold coming through on the loan basis as we have in past but [ph] the scrap margins (00:19:52) have improved which means we'll capture a bit of that gold price through the scrap. Most of our – a lot of our jewelry content actually involves diamonds as well, so it's not outright gold. I think people are just holding off at the moment due to the fact they've got stimulus checks in their pocket. There's no real rush for them to come in and pull, as you've seen, with a decline of balances as they have surplus cash in their hand.

So at this stage, I think there is a bit of just waiting to see from our customers. When they run out of cash, we may see a bit more gold coming into us, but at this moment we haven't seen the rushes perhaps we saw back in 2000 and 2008 and 2009 when there was less stimulus and people were quite active in bringing their jewelry to us to either loan or purchase.

Gregory Pendy
Analyst, Sidoti & Co. LLC

Q

Great. That's helpful. And then just one more, just on Lana, on the rollout, have you guys rolled out that with mobile functions and is there more to come? Where are you on that front?

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

A

So what do you mean in terms of my mobile functions, Greg?

Gregory Pendy
Analyst, Sidoti & Co. LLC

Q

I believe you had some mobile capabilities that you were looking to roll out at some point, I may be mistaken on that.

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

A

Yeah, I'm not sure, [indiscernible] (21:01) it's all on the phone if you've got a web enabled app, which you can use on the phone pretty, pretty easily, and we are increasing the utility of that function. But I'm not sure whether that specifically answers your question.

Gregory Pendy
Analyst, Sidoti & Co. LLC

Q

No, that's helpful. We can take the rest of that offline. Thanks.

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

A

Yeah. Sure. Thanks, Greg.

Operator: And our next question comes from the line of Scott Buck from B. Riley FBR. Your line is open.

Scott Buck
Analyst, B. Riley FBR, Inc.

Q

Hey, good morning, guys. I was hoping you might be able to provide a little bit of a history lesson. Curious if we look back to the 2008-2009 financial crisis where PLO peaked versus pre-crisis levels and sort of what was the cadence of that ramp during that period?

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

A

Hi, Scott. I'll have a crack at that and I'll see if Jason could add to it. This is bit of a different scenario. What we've are seeing here is bit of an unemployment late recession whereas in the late 2008-2009, employment was a bit of a lag and it certainly went to stimulus payments. So what we've seen is a rapid pay down of the loan balances rather than the slow increase in the loan balances.

So 2008 and 2009 aren't really that representative of what we are seeing today. I think the closest that we try to understand is whether something like the hurricanes that we saw through Houston and in Miami earlier last year can provide us with any insight and we saw it took – with the theme of payments, it took a couple of months before we started seeing the loan activity growing back. And on that case, it probably took around up to 12 months for the loan balances to come back. We're not sure how exactly to model it, which I am sure is what you are looking at as well, Scott, is given the stimulus that is in the economy at the moment. And if you look at some of the most recent reports, it seems to suggest that whoever's in [indiscernible] (22:53) that are receiving the unemployment benefits from the federal and the state are probably getting paid more than they would to work. So if that starts winding down, we think we'll see it come back. But probably the added advantage or disadvantage for some of our customers is that with the unemployment rate, as high as that is, we may see an increase in the population that are looking to the pawn and loan industry given that the payday is probably shrinking and given the lack of employment for which they basically pay their loans on.

So we think there might be an increase in the potential populations who would use our loans, but we still think it's probably couple months before we'll start seeing the tick up back to the normal levels of loan demand that we've seen.

Jason, would you add anything to that?

Jason A. Kulas
President & Chief Financial Officer, EZCORP, Inc.

A

Yeah, just briefly we have a new slide this quarter, slide 6, that goes through some of the economic trends that that Stuart just mentioned and he also mentioned in some of the prepared remarks. But what's important about that is we sort of know how this story sort of plays out. Right now the stimulus checks are driving the behavior that they're driving. But we know at some point our consumers are going to need cash. And so that's where you see some similarities to maybe prior periods of stress. The comparison to the hurricanes is something we've been talking about a lot internally as Stuart mentioned.

But the nice thing for our business is for now while the cash is strong, we're benefiting on the retail side particularly as people are buying goods for working and schooling and from home, coming to us to buy things they need to spend more time with their family, game consoles, TVs, those kinds of things and laptops. And then when the cash begins to sort of not be as strong and the loan demand picks up, we're positioned to be able to meet those needs and to be there for our customers as we continue to build our cash balances.

Scott Buck
Analyst, B. Riley FBR, Inc.

Q

Okay. I appreciate that color, guys. Thank you.

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

A

Thanks, Scott.

Operator: [Operator Instructions] I would 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 I know this is tough times and everyone's really busy, so appreciate the time that you've taken to listen to the call, and Beth and I are around obviously take some calls later on through the next few days. But stay safe, and we look forward to talking soon. Thanks very much.

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