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EZCORP, Inc. (EZPW)

Q4 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and welcome to the EZCORP Fourth Quarter 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 [ph] Michael Kim (00:00:22), Investor Relations. Please go ahead, [ph] Michael (00:00:24).

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.

Thanks, [ph] Michael (00:01:35), and good morning, everyone. We look forward to giving everyone an update today on our strategy and the focus we are putting on store level operations, overall efficiency and long-term growth.

As a leading provider of pawn loans in the US and Latin America, we play a vital and essential role in ensuring that our customers have access to the short-term cash they need. Our retail operations also play an important and ongoing role in recycling secondhand goods. We believe strongly that over the next few years, we will build shareholder value as we continue to improve our ability to meet these needs.

As Tim and I will discuss in detail, our results for the fourth quarter of fiscal 2020 were negatively impacted by the declines in pawn loans outstanding and inventory, primarily related to the COVID-19 pandemic. The follow-on effects of the stimulus as well as write-offs and charges related to cost saving and streamlining initiatives. And while we have seen a strong and continued rebound in new pawn loans made since the trough in June, it will take an extended period of time for recent trends to be fully reflected in our financial performance as we look into fiscal 2021.

In addition, any additional stimulus could impact business performance. That said, recent strategic and financial initiatives position us well for sustainable long-term growth as we increasingly leverage our durable competitive advantages, including scale with a large store base spread across diverse markets and exceptional talent position to continue to provide essential services to a growing base of customers.

Starting on slide 4 of the investor presentation, our top priority is team member retention and well-being. We remain focused on the health and safety of our team members during the pandemic and have enhanced diversity and inclusion training with our efforts continuing to pay dividends through declining attrition at the store level here in the US and across Latin America.

Turning to our customers, we remain focused on accessibility with virtually all of our stores remaining open, and payment flexibility by broadening options across stores and online, and service by maintaining appropriate store staffing levels. We are giving our customers more choices in how to access our services particularly through our online Lana platform where we have seen a continued increase in volume since the end of Q3. And this benefit will last well beyond the pandemic.

Finally, from a financial standpoint, we maintain a strong balance sheet with over $300 million of cash at quarter-end and no near-term debt maturities, positioning us well to serve our customers as their short-term needs for cash increase over time. And we remain focused on cutting costs with restructuring efforts at the executive level and the rationalization of our digital efforts in addition to streamlining operations as evidenced by our recent closure of CASHMAX in Canada as well as the closure of nine pawn stores in the US and Mexico.

On slide 5, we'll walk through key financial themes for the quarter. First, we implemented meaningful cost savings initiatives and remain committed to ongoing expense reductions to continuously improve operating efficiencies. I will discuss our efforts in more detail in a bit, but notably, we will realize recurring savings of over $12 million in corporate expenses as a result of our initial program.

Second, the revenue backdrop remained challenging during the fourth quarter. Total revenue for the quarter was down 20% year-over-year primarily driven by lower pawn service charges given softer demand for pawn loans related to the impact of stimulus payments and COVID-19 headwinds. Merchandise sales were up slightly compared to the fourth quarter of fiscal 2019. But as we indicated last quarter, scrap sales were down meaningfully, primarily reflecting a softer diamond market and limited inventory in advance of the holiday sales season.

Lower inventory is holding back sales, but our teams in the stores are doing a great job of selling what we have and managing our inventory holistically, a direct result of our enhanced inventory management programs. In aggregate, aged general merchandise inventory stood at $2.5 million or 5.8% of total inventory at the end of September 2020, down from $6.3 million or 6.3% of total inventory at the end of fiscal 2019. Much of the year-over-year improvement can be linked to effective management in the US as well as rising inventory turnover rates.

Looking ahead, we expect operating results to remain under pressure in fiscal 2021. Tim will discuss our financial outlook in more detail, but at a high level, it will likely take several quarters for pawn service charges and merchandise sales to return to pre-COVID levels even as PLO and inventory continue to grow, given the inherent lag between assets and related revenue. While results for fiscal 2021 will be under pressure, we are confident that the actions we are taking on operations and expenses are going to give us operating leverage as the business recovers, a recovery we are already beginning to see with PLO continuing to grow.

Finally, on the capital front, we remain focused on managing capital expenditures with ample liquidity on the balance sheet to fund accelerating PLO growth, some amount of de novo store openings and to capitalize on potential M&A opportunities.

Slide 6 is a graphical representation of the pieces we have put in place to strengthen and grow our core pawn business. As mentioned earlier, everything we do is built on the strength of our tenured team members and with a focus on serving our customers. Next, key strategic initiatives remain strengthening the core, cost reduction and simplification, and continuing to innovate and grow, which we'll walk through next. And as we execute on our plans, that will drive improving and sustained growth, financial results and shareholder value. One of the key messages in this new slide is that each of these components is critical. Without even one of them, our strategy is incomplete.

So, starting with cost reduction and simplification on slide 7. In an effort to better align with the near-term PSC trajectory and to maximize profitability when revenue growth resumes, we implemented a number of cost reduction actions during the quarter. More specifically, we streamlined head count at both the corporate and field levels and consolidated the digital and Lana teams. We also renegotiated vendor contracts and leases, closed the non-core CASHMAX business in Canada and scaled back CapEx plans. We note that CASHMAX charges have come in better than expected due to better collections and vendor negotiations.

As a result of these early initiatives, we realized more than $12 million of recurring annual cost savings beginning in fiscal 2021, mostly related to administrative expenses. On top of that, we realized approximately $14 million of annualized cost savings related to labor in stores. However, these savings are likely to be temporary in nature as we expect the majority of related costs will be added back as transaction activities in stores return to normal levels.

Importantly, this is the beginning of a journey. Looking beyond our initial reductions, we see further opportunities to extract operating efficiencies in fiscal 2021, including simplifying and centralizing common corporate functions, standardizing back office and store processes across geographies, and rationalizing data and reporting activities across the company. And over the next couple of years, as illustrated in the slide, the goal is to identify and automate corporate and store level processes to save time and costs as well as reduce risk. Furthermore, we remain focused on leveraging our digital platform to broaden engagement across channels and improve customer experience.

Next on slide 8, we provide an update on our efforts to optimize and modernize our IT infrastructure. As we further develop and populate our point-of-sale system, we look to increasingly capitalize on more insightful product pricing intelligence, rising team member productivity and increased inventory velocity. In fact, in the fourth quarter, loan-to-value ratios on 400 merchandise across both the US and Mexico declined by more than 10%. This is directly attributable to our improved processes and lending guidance enabled by our new point-of-sale system. And we remain focused on consistently reviewing and refining loan-to-value ratios on a customer and product basis to maximize returns on earning assets. More broadly, we're in the process of implementing a comprehensive retail strategy leveraging the uniqueness of pawn and the recycling of secondhand goods.

On the IT modernization side, we continue to make progress against key strategic initiatives including the rollout of our enhanced quantum scale system across Latin America, the ability to process retail sales, loan extensions and customer lookups across channels, the centralization of data management and network upgrades across our stores.

Turning to our innovation and growth initiatives on slide 9. A key strategic priority remains broadening customer engagement to service more customers more frequently. Importantly, we are repositioning Lana as a digital pawn channel. As I mentioned, everything we do will now be assessed through the lens of whether or not it makes our core pawn business better. In the case of Lana, our existing and near-term offerings do just that. Customers can access loan extension capabilities across all eligible states, and over 70,000 Lana bank accounts were funded in fiscal 2020. Instead of operating Lana as a separate team, going forward, we have integrated the Lana team into the core EZCORP family to reduce costs and increase throughput with development focused on layering in other pawn capabilities including layaway payments.

Next, improving service remains critical to retaining existing customers and winning new ones. That means providing loan extension payment options in any of our stores by phone or online with any debit card, leveraging customer feedback and data analytics and continuing to optimize our store footprint. Also, we continue to develop our digital marketing strategy with a focus on expanding our online and social media presence. We recently launched new websites for three of our US pawn brands and continue to enhance digital metrics to capture new customers and generate higher returns.

Finally, in terms of store growth, we are reassessing our de novo strategy in light of the ongoing pandemic. And while this will continue to be a key part of our growth strategy, we will likely open fewer stores than we did in fiscal 2020. We also remain focused on capitalizing on acquisition opportunities across core and new markets that meet our strategic and financial criteria.

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. I wanted to stop by spending a few minutes walking through the natural lag that exists in the pawn business between new loans made and the ultimate revenue from their activity, pawn service charges, and sales.

On slide 10, we graphed out trends across new loans made, PLO and PSC, as well as PLO versus inventory and ultimately merchandise sales. Before March, there was a reasonable timing consistency between growth in the pawn loan book, inventory and related PSC and merchandise sales. Those earlier quarters were characterized by stable loan and inventory balances in the US. The graph on the top half of the page show there was substantial shock between the new loan demand beginning in April when stimulus payments were made. While the loan balance declined in the June ending quarter, PSC did not reflect that fully until the following quarter. It is also notable that the degree to which PSC revenue decreased is less than the decline in the PLO balance.

We have witnessed a significant sequential improvement in PLO since June. But as I just described, average PLO is indicative of the next quarter's PSC revenue. And PSC is expected to fully recover in the quarter following a return to normal new loan originations volume. The delay in loan forfeitures that drive our inventory is at least 90 days after the time of origination. And if we turn our inventory at a rate of 3 to 4 times a year, the average item would sell after 100 or so days in inventory. Based on that, we expect to see inventory balances begin to recover in our fiscal Q3, Q4 after-tax season with sales volume fully recovering on a run rate basis at the end of fiscal year 2021.

Now turning to our results for the fourth quarter, we reported a loss of $0.42 per share on a GAAP basis compared to a loss of $0.01 for the prior fiscal year's fourth quarter. On an adjusted basis, we reported diluted earnings per share of $0.07 for the fiscal fourth quarter compared to $0.13 in the prior year quarter. Adjustments for the quarter included charges and non-cash write-downs associated with our efforts to simplify and streamline the business and other COVID-19 impacts, as well as our typical exclusion of non-cash interest expense related to our convertible debt and adjustments for foreign exchange fluctuations. I'd also point out the GAAP and adjusted EPS for the quarter included a reversal of $21 million in short-term and long-term intended compensation accruals.

Focusing on our consolidated financial results for the fourth quarter on slide 11, net revenue was down 25% year-over-year primarily by ongoing COVID-19 impacts. Our ending PLO balance of $134 million was down 33% year-over-year driving lower pawn service charges. PLO increased $18 million on a sequential basis during the quarter, reflecting strengthening the loan demand.

Merchandise sales were up 1% year-over-year for the quarter while related gross profit was down 7% due to lower margins reflecting aged inventory reduction in Latin America, partially offset by further inventory management improvement in the US. Low inventory levels and less collateral becoming inventory will put pressure on sales and scrapping until PLO rebuilds.

Turning to US pawn on slide 12. Ending segment PLO was down 32% year-over-year with PSC down a similar percentage driven by a lower average PLO for the quarter, partially offset by an improvement in yield. We continue to leverage our enhanced point-of-sale system to optimize loan-to-value decisions and drive high pawn loan redemption rates and yields.

Turning to the retail side of the business, our merchandise sales for the quarter softened 4% compared to the prior year period. Our merchandise margin expanded by 200 basis points driven by effective inventory management. More specifically, aged general merchandise inventory improved to $1.2 million or 4.3% of total inventory as of September 30 from $4.6 million or 6.5% of total inventory a year ago. Finally, while adjusted operations expense were down 12% versus the prior year quarter due to cost reduction initiatives, EBITDA was down 48% for the quarter primarily reflecting the lower pawn service charges.

Next on slide 13, Latin America segment results remain depressed with minimal EBITDA contribution for the quarter. PSC was down 33% driven by lower average PLO for the quarter and modestly lower yield primarily to the lower activity from COVID-19 transportation limits and reduced hours across Guatemala, El Salvador, Honduras and Peru. Our merchandise sales were up 13% for the quarter, reflecting a step over in volumes in light of aged inventory reduction efforts. Related gross profits and margins were down in the fourth quarter of fiscal 2020.

Going forward, recent progress on inventory management with aged merchandise inventory down over 70% on sequential quarter basis as well as strategic initiatives to optimize LTVs, position our Latin American business for rebuilding yields and merchandise margins over time. Looking ahead, we expect to incur additional operating losses in fiscal 2021. As I discussed earlier, the drop in PLO and inventory assets earlier this year, primarily a function of the ongoing COVID-19 pandemic and subsequent government stimulus programs, continues to negatively impact pawn service charges and merchandise sales and gross profits given the timing lag between asset and revenue growth.

Ultimately, the scale and pace of the recovery in pawn loans outstanding and inventory levels as well as the size, mix and implementation of potential further stimulus packages will determine the trajectory and timing of our return to operating profits. More favorably, our recent efforts to rightsize our cost structure will help lessen operating losses in the near term and enhance earnings growth and profitability over time as revenue builds. Furthermore, we expect to continue book tax benefits looking out to fiscal 2021.

Before we open the call for questions, I'd like to turn the call back over to Jason for some closing comments.

Jason A. Kulas

Chief Executive Officer & Director, EZCORP, Inc.

Thanks, Tim. Stepping back, we remain focused on optimizing our core pawn business to address customers short-term cash needs. And we've made significant progress in driving continuous operational improvements that we believe will result in more consistent financial performance as well as building earnings power and shareholder value over time.

More specifically, we are rightsizing our expense base and maintaining an ongoing focus on extracting further efficiencies, while preserving operating leverage's transaction activity and asset levels rebuild. Related to that, we've rationalized noncore activities and maintained a strong and liquid balance sheet to invest and grow. Second, we continue to strengthen our core pawn business by increasingly leveraging data analytics to optimize pricing, productivity and returns. Finally, we remain focused on innovation to broaden customer engagement across channels, improve the customer experience and gain market share.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. At this time, we'll be conducting a question-and-answer session. [Operator Instructions] Our first question comes from the line of John Hecht with Jefferies. Please proceed with your question.

John Hecht
Analyst, Jefferies LLC

Q

Hey. Thanks very much for taking my questions. Good morning.

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

A

Good morning.

John Hecht
Analyst, Jefferies LLC

Q

First, I just want to make sure I understand the cost saves just so I'm clear on it. It sounds like you've got $12 million of admin expenses that would be permanent cost saves and that you've temporarily reduced $14 million out of store cost saves, which will come back as business expands. Is that the right interpretation of the cost saves?

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

A

That's right. Yeah. Because of the timing of it, some of that $14 million will stick because there'll be a ramp back up to those levels. But that's exactly right.

John Hecht
Analyst, Jefferies LLC

Q

Okay. That's helpful. And then in terms of forward-looking factors, you – the commentary was on more operating losses. Is that consolidated or is more tied toward Latin America in terms of how I interpret that guidance? And is also that just the – are you kind of just cautioning us for a couple quarters? Is there something we should expect over the full year? And I guess generally on this topic is, how do you see the demand recovery in both the US and Mexico, assuming a modest stimulus package different than the first one? How do we see the business recover?

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

A

Sure. The comments were more consolidated. And our – what we're seeing right now that we're actually very encouraged by is we are seeing a rebounding portfolio. We're seeing an increasing level of demand. And you're seeing that reflected in our pawn loans outstanding. So, we talked about, in September, the overall pawn loans outstanding being down in the low 30s versus last year. As we moved into October, it was closer to 30% down from last year. As we moved into November, it's in the kind of mid-20s, down from last year.

So, those numbers are getting incrementally better. Our caution is really more along the lines of just some of the uncertainty, the things that we don't know around – any shutdowns related to COVID-19, any impact of future stimulus depending on the form that takes, and then going into tax season and those kinds of things that typically would seasonally impact loan demand. But all in all, we're seeing a consumer who's coming back, who has an increasing level of demand for the services we provide. And we see that by the time we get to the end of fiscal 2021 and through some of the interim things we're less certain about, really paying some dividends for the company.

John Hecht
Analyst, Jefferies LLC

Q

Okay. And do you see – is the recovery in demand that you cited, is it consistent in the US or in Mexico or LatAm generally, or are you seeing different cadences in those two different geographies?

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

A

That's a good question. It's better in the US. The US has come back faster for sure. In Latin America, in Mexico, it's also begun to come back but at a much slower pace. And then in our Central America locations, it's – we've continued to be impacted by just the delays that happened there related to more severe shutdowns. That's a smaller part of the business. But the biggest driver of the growth right now is the US.

John Hecht
Analyst, Jefferies LLC

Q

Okay. Wonderful. Thanks, guys.

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

A

Thanks, John.

Operator: Thank you. [Operator Instructions] Our next question comes from line of Greg Pendy with Sidoti & Company. Please proceed with your question.

Gregory Pendy
Analyst, Sidoti & Co. LLC

Q

Hi. Thanks for taking my questions. First, just on the $14 million temporary labor cost cuts, how much flexibility do you think you'll have in terms of re-ramping that up? I think with a lot of retailers when they made the cutbacks, they were kind of caught short when demand snapped back. Just, I mean, are you comfortable that that can scale pretty flexibly with how you're going to see demand come back?

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

A

We are. We've done that very carefully. Most of the store level cuts that we made were just letting attrition happen and those kinds of things. We did it very gradually. And as we see demand return, we'll do the same. We'll stay on top of it and add those resources and expenses as we see the need to do it. So, I feel like our ability to do that is still pretty good. And we'd rather be on the prudent side and manage those expenses conservatively while we're going through this interim period.

Gregory Pendy
Analyst, Sidoti & Co. LLC

Q

Okay. Great. And then the next question, I think on slide 10, you had that chart which was very helpful of PLO versus inventory. And I'm just kind of curious, I mean, given inventory levels are obviously pretty lean right now, what is the risk that it curbs a little bit of traffic to the stores and maybe even people who might have looked for a loan just because I have to assume that you're kind of light on inventory, not many people are just going to go into the store?

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

We are – it's good point. So, we are light on inventory relative to where we've been historically. But I'd say one of the comments we made also is that our store level teams are doing a great job of selling what we have. At the same time, though, you're right, as you think about traffic in the stores and those kinds of things, we're doing as – we have a lot of initiatives right now to drive more traffic into our stores, a lot of efforts on the digital front, on the social media and marketing front, updating websites, those kinds of things because we want the feed the funnel as well as we can as we go through this period where inventory is down.

At the same time, if you look at our business historically, we've managed with a whole lot more inventory than some others have in the industry. And for us to get to a more efficient level of inventory and maintain that over time is actually a good thing. So, we'll want to settle into a level of inventory that's a little bit better than what we have now but still short of where we were historically. And that'll be a good thing for us in terms of inventory turns and margins and overall inventory management.

Gregory Pendy
Analyst, Sidoti & Co. LLC
Q

Great. And then just one final one, you said the loan-to-value ratios have declined. I mean, how much opportunity is there to still remain competitive with other pawn stores on that?

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

We have a lot of opportunity there. So, one of the things we've invested in, as you know, is our point-of-sale system, which is allowing us to price more and more of our transactions in the system. It allows someone to come in who may not be an experienced pawnbroker and operate within our system to become one a little more quickly. And as you see that at this point in the process where you're setting more and more prices in the system, putting guardrails against the range of loan to values that can be put on certain items, that helps you competitively because you're more consistent, but then it also helps you on the back end as you're selling items, the drop in inventory where you find yourself sort of in them for the right level.

But the other point on LTVs that we were making is that the items that are dropping have lower LTVs, but the items that aren't dropping have higher LTVs. So that's the other part of the discipline that's really helping us a lot. It is not necessarily that we've seen a lot of movement in LTV. In fact, if you look at year-over-year LTVs, they're slightly higher on general merchandise but not significantly higher. And on jewelry, they're slightly lower just because gold prices are so much higher. But within a range, they really haven't changed that much. What's been changing is the LTV of the items that dropped which is a really good thing for us in terms of how we need to sell those items and make sure we get a good sales, gross profit when we do it. So, we're pretty pleased with how that's going so far. Obviously, you're right, you need to be competitive from a loan to value standpoint, and we feel like we are, but adding discipline to the process is going to give us more consistency and predictability we think.

Gregory Pendy
Analyst, Sidoti & Co. LLC

Q

Okay. Great. And then one final one. Since you did mention gold, I have to ask any kind of interest or uptick you're seeing in pawn loans targeting gold out there given the prices?

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

A

We are – in the US we're seeing a little bit of a pickup there, not as much in Latin America. But in the US, we are seeing a little bit of a pickup. And clearly, you mark your gold tables to reflect where the prices are. You're lending more per item as well. But we feel like those LTVs are still within really acceptable range. And it's something that we watch very closely. But obviously, having gold prices go up for what's already on the books has been a good thing as well and we've seen that over the past couple of years.

Gregory Pendy
Analyst, Sidoti & Co. LLC

Q

Great. Thanks a lot.

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

A

Thank you.

Operator: Thank you. Ladies and gentlemen, that concludes our question-and-answer session. I'll turn the floor back to Mr. Kulas for any final comments.

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

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. This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.