# EZCORP, Inc. NasdaqGS:EZPW

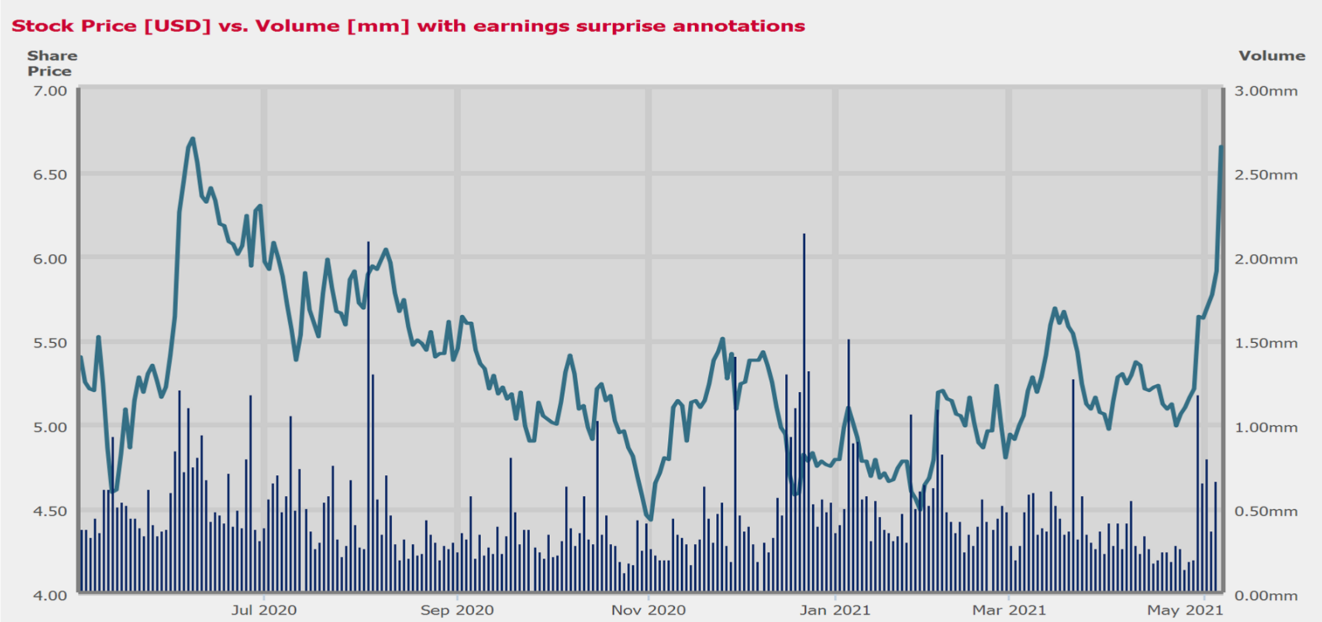
# FQ2 2021 Earnings Call Transcripts

## Thursday, May 06, 2021 12:00 PM GMT

## S&P Global Market Intelligence Estimates

| | -FQ2 2021- | | | -FQ3 2021- | -FY 2021- | -FY 2022- |
|---|---|---|---|---|---|---|
| | CONSENSUS | ACTUAL | SURPRISE | CONSENSUS | CONSENSUS | CONSENSUS |
| **EPS Normalized** | (0.07) | 0.17 | NM | (0.03) | 0.04 | 0.54 |
| **Revenue (mm)** | 159.81 | 184.94 | ▲15.72 | 173.40 | 676.60 | 767.46 |

Currency: USD
Consensus as of Apr-30-2021 1:32 PM GMT




| - EPS NORMALIZED - | CONSENSUS | ACTUAL | SURPRISE |
|---|---|---|---|
| **FQ3 2020** | 0.10 | (0.01) | NM |
| **FQ4 2020** | (0.08) | 0.07 | NM |
| **FQ1 2021** | (0.04) | 0.13 | NM |
| **FQ2 2021** | (0.07) | 0.17 | NM |

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# Call Participants

### EXECUTIVES

**Jason A. Kulas**
*President, CEO & Director*

**Michael Keim**
*Director of Financial Planning and Analysis/Pricing*

**Timothy K. Jugmans**
*Interim Chief Financial Officer*

### ANALYSTS

**Gregory R. Pendy**
*Sidoti & Company, LLC*

**John Hecht**
*Jefferies LLC, Research Division*

# Presentation

**Operator**

Good morning, ladies and gentlemen, and welcome to the EZCORP Second Quarter Fiscal 2021 Earnings Conference Call. [Operator Instructions]

As a reminder, this call may be recorded. I would now like to turn the conference over to Michael Keim, Investor Relations. Please go ahead, Michael.

**Michael Keim**
*Director of Financial Planning and Analysis/Pricing*

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 contain 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**
*President, CEO & Director*

Thanks, Michael, and good morning, everyone. As always, I want to start by recognizing the continued hard work and dedication of all of our team members. We've made tremendous progress in positioning our core pawn business for sustainable growth coming out of the pandemic. And none of that progress would have been possible without the enthusiasm, determination and relentless efforts of all of our team members who are so passionate about serving our customers.

I also want to specifically acknowledge Tim Jugmans. His insights and leadership have been instrumental in all that we have achieved over the last year or so and instrumental in our future. And the board and I are pleased to appoint him Chief Financial Officer, officially removing interim from his title. This move gives us great stability and continuity on the financial side of our business. I know Tim shares my excitement for the opportunities in front of us, and I look forward to carrying on our partnership as we continue to strengthen and grow our core pawn business to address our customers' needs for cash and affordable preowned merchandise across the U.S. and Latin America.

So starting on Slide 4. The road map we lay out here hasn't changed and our strategy is intact. But we wanted to reinforce all of the progress we've made by highlighting some key accomplishments. First, continuously developing our team member base remains foundational for driving sustainable growth and profitability. We've implemented new diversity and inclusion initiatives as well as enhanced recognition programs, and we're seeing the benefits of our efforts through rising productivity and declining attrition.

On the customer side, we installed store traffic counters in our U.S. stores, allowing us to better understand customer behaviors to inform pawn and sales strategies. In terms of strengthening the core, merchandise sales gross profit was up strongly with related margins up nearly 900 basis points year-over-year, reflecting higher inventory turns and declining aged general merchandise inventory.

Reducing costs and further streamlining the business remains a key strategic priority. We'll dig into this later in the discussion, but we continue to make progress on this front and have now increased our targeted annual cost savings to more than $14 million after also increasing the number last quarter from our original projection.

We also remain focused on strategically expanding our store footprint, and we have added 17 stores since the end of our fiscal first quarter in December, a 1.7% increase in our total store count. We opened 4 new stores in Latin America in the second quarter and an additional 2 stores since the end of Q2. And we recently acquired 11 stores in Houston, strengthening our presence in Texas. All of these pieces contributed to our strong financial performance for the second quarter and set us up well for a considerable step-up in earnings power over time as our PLO rebuilds.

Turning to Slide 5. Key financial themes for the quarter included steady earnings on a year-over-year basis. Adjusted EPS for the quarter came in at $0.17, consistent with the level in the second quarter of fiscal 2020, as the expected decline in net revenue was offset by reduced expenses.

Net revenue was down 11%, with the decline mostly a function of the decrease in pawn transactions outstanding and pawn service charges. PLO ended the quarter at $123 million, down 24% on a year-over-year basis, reflecting increased government stimulus in the quarter in addition to typical seasonal headwinds related to tax refunds.

Tim will discuss our forward outlook in more detail, but it's important to point out that stimulus payments in an extended tax season have remained in play here in the U.S. thus far this quarter. As a result, pawn demand has softened, putting near-term pressure on pawn service charges, which will take time to work through even as PLO rebuilds. Having said that, we've been very pleased to see pawn balances begin to increase since mid-April.

Turning to the retail side of the business. While lower inventory levels continued to pressure sales, merchandise sales gross profit was up strongly year-over-year, driven by higher margins. For the quarter, merchandise sales margins reached 43% with ongoing improvements in inventory turnover and aged general merchandise inventory levels, reflecting our focus on more effectively operating the business at the store level.

Our cost optimization program continues to drive meaningful savings, and we remain diligent in uncovering and realizing further efficiencies as part of our culture. And finally, our balance sheet continued to strengthen. With just over $335 million of cash on hand at quarter end and no near-term debt maturities, providing us with ample liquidity and flexibility to fund PLO growth, finance de novo store openings and capitalize on M&A opportunities if and when they arise.

Slide 6 highlights the progress we've made against our cost reduction and simplification efforts. When we implemented our expense reduction initiatives in the fourth quarter of fiscal 2020, we initially targeted realizing approximately $12 million of recurring annual savings, mostly related to G&A. Over the last couple of quarters, we've identified incremental efficiencies and now expect to achieve more than $14 million of annual cost savings.

G&A costs decreased by 11% for the second quarter compared to the prior year quarter, resulting in a 22% decline through the first 2 quarters of fiscal 2021. Store expenses decreased by 7% for the quarter on a year-over-year basis and 9% when looking at year-to-date costs.

Going forward, we remain focused on extracting further operating efficiencies without sacrificing our potential for growth. In that regard, we expect store expense to gradually trend higher as transactional demand increases.

On the left side of Slide 7, we call out some of our key member initiatives. We continue to believe that reporting strong financial results is directly tied to our ability to attract and retain a well-trained, motivated and diverse workforce. And then we concentrate on technology on the right side. Ongoing tech initiatives include expanding sales and payment options, further enhancing our digital pawn servicing platform to broaden customer engagement and increasingly leveraging our data across geographies to inform more systematic lending and pricing decision.

Turning to our innovation and growth initiatives on Slide 8. We continue to build out the functionality of our Lana digital pawn channel. Online extension transactions were up 70% on a sequential quarter basis. Our related PSC collected was up 2x compared to the first quarter of fiscal 2021. In addition, layaway payment options are now available for all of our U.S. stores with more than 1,000 payments made during the quarter. Our customers continue to tell us that they want choices in how they interact with us, and we are pleased to provide these convenient options.

Second, ongoing customer service initiatives include enhancing online account management and centralized support capabilities, which are driving real-time improvements in online reviews and customer retention.

Our digital initiatives go beyond account management and customer support. We continue to make inroads on the digital marketing side by leveraging search engine optimization and social media to enhance customer acquisition. And as mentioned earlier, we deployed traffic count technology in all of our U.S. stores to track related campaign analytics.

And finally, we remain focused on increasingly leveraging our strong and liquid balance sheet to fund de novo store openings and potentially capitalize on M&A opportunities to further enhance our footprint and growth profile.

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

**Timothy K. Jugmans**
*Interim Chief Financial Officer*

Thanks, Jason. For the second quarter of fiscal 2021, we reported diluted earnings per share of $0.10 for the quarter on a GAAP basis compared to a loss of $0.74 for the prior fiscal year second quarter, which included $47 million goodwill and intangible asset impairment charge. On an adjusted basis, diluted EPS was $0.17 for the quarter, consistent with the prior year quarter. Similar to the first quarter, adjustments for the second quarter were mostly limited to our standard practice of adding back noncash interest expense related to our convertible debt.

Focusing on our consolidated financial results for the second quarter on Slide 9. PLO ended the period at $123 million, down 24% on a year-over-year basis, mostly a function of multiple rounds of government stimulus payments. Following suit, PSC revenue declined 21% compared to the prior year quarter's level.

Merchandise sales were down 11% year-over-year, largely reflecting lower inventory levels. That said, merchandise sales gross profit was up 12% on more favorable profitability. Merchandise sales gross margins expanded by 890 basis points from the prior year quarter to 43%, primarily driven by reduced aged inventory levels and higher sales velocity.

Inventory turnover improved to 3.1x from 2.1x a year ago, and the aged general merchandise inventory ratio continued to decline from 8% of total GM inventory a year ago to just 2% as of the end of the second quarter of fiscal 2021.

Finally, rising sales gross profit and inventory -- and lower inventory levels continued to drive our elevated return on earning asset ratio, which reached 199% for the quarter, up from 137% in the prior year quarter.

Consolidated EBITDA was down 23% compared to the second quarter of fiscal 2020 with softer PSC revenue, partially offset by higher merchandise gross profit and lower expenses. As Jason discussed earlier, continued focus on expense control decreased store expenses by 7%, while general and administrative costs were down 11% year-over-year.

Turning to our U.S. pawn operations on Slide 10. Segment PLO was down 22% on a year-over-year basis. This led to a 20% decline in PSC, driven by lower average PLO for the quarter, partially offset by year-over-year improvement in PLO yield due to a higher redemption rate.

On the retail side of the business, merchandise sales decreased 8% compared to the second quarter of fiscal 2020. More favorably, merchandise sales gross profit was up 13% and related margin expanded by 850 basis points to 45% from 36% a year ago, reflecting ongoing inventory management initiatives.

Reinforcing our progress, aged general merchandise inventory continued to decline and now stands at just 400,000 or 2% of general merchandise inventory versus $4 million or 6% of the total a year ago. Moreover, sales velocity continues to trend higher with inventory turn up to 2.9x during the second quarter or 45% higher than a year ago.

From a bottom line perspective, U.S. pawn EBITDA was down 14% compared to the prior year quarter with lower pawn service charges, partially offset by higher merchandise gross profit and lower expenses. We remain focused on tightly managing expenses with U.S. store expenses down 6% year-over-year, mostly labor-related.

Turning to our Latin American pawn operations on Slide 11. Segment PLO declined 29% compared to a year ago, largely reflecting headwinds around constrained traffic, limited operating hours and elevated remittances from the U.S.

PSC was down 24% as lower average PLO for the quarter was offset by a more favorable PLO yield due to a higher redemption rate. Merchandise sales declined 20% versus the prior year quarter, but the segment's merchandise sales gross margin expanded by 940 basis points, driven by increased sales velocity. Inventory turn is up 60% to 4x. Moreover, general merchandise inventory decreased to just 3% of total GM inventory versus 11% a year ago.

EBITDA was down 48% year-over-year to $3.9 million on lower PSC, partially offset by higher merchandise sales gross profit and lower expenses. Store expenses of $18 million were down 4% year-over-year, driven by lower labor costs.

Finally, we opened 4 de novo stores in Latin America during the quarter and 2 more since the end of the quarter, with new stores typically pressuring earnings in the short term as they ramp up while driving higher profitability over time.

Looking ahead, PLO balances remained under pressure through mid-April, reflecting lingering impacts from the second stimulus package as well as a delayed tax filing season in the U.S. Furthermore, trends in Latin America remained challenged due to the factors previously mentioned. These macro-related factors have continued to temporarily reduce pawn demand. In the second half of April, we have seen a return in pawn demand from the mid-month low, which is an encouraging sign.

From a timing perspective, the natural lags that exist in the business between pawn growth and the ultimate revenue impact, mostly in the form of pawn service charges will pressure our top and bottom line in the near term, particularly in the fiscal third quarter, given the lower starting point for PLO. On top of that, lower inventory levels remain a near-term headwind for merchandise sales on an absolute basis. So despite ongoing expense reductions, we expect adjusted EPS to turn negative for fiscal third quarter.

With pawn demand picking up since mid-April and demand trends normalizing over time, we expect regular sales discounting to return, which will bring merchandise margins back to typical levels, albeit at the higher end of the historical range. We also expect store expenses to increase in line with increased transaction volume.

As demand for our pawn offering normalizes, we have positioned the company for a meaningful step-up in earnings power. Particularly in light of ongoing cost-saving initiatives and simplification efforts across the business, increasingly leveraging differentiated technology and data analytics to further enhance pawn lending economics and redemption trends as well as deeper customer engagement via digital servicing and payment capabilities.

I will now turn it back over to Jason for a few summary comments.

**Jason A. Kulas**
*President, CEO & Director*

Thank you, Tim. At the end of last summer, we began talking internally about a journey to put EZCORP on a path to long-term sustained success. We intentionally kept our strategy simple, focusing on pawn and operating our core business more effectively, permanently embedding a higher level of cost consciousness in everything we do and continuing to invest in innovation and store growth. The acquisition we just announced in Houston adds 11 stores to an important market for EZCORP and also validates the tremendous amount of effort we've put into developing a strong M&A pipeline.

At the halfway point in our fiscal year, we are proud of the accomplishments we've made in each of these areas and the way they are showing up in our operating metrics. Better margins, increased inventory turns and sales velocity, lower expenses, more stores, these metrics should drive improved financial performance for EZCORP as both pawn and retail demand increase over time.

We are passionate about meeting the short-term cash needs of our customers and providing preowned retail merchandise that is both affordable and environmentally friendly. And we are equally passionate about staying true to the journey we began last year. We look forward to continuing to discuss our progress in future quarters.
And with that, we'll open up the call for questions. Operator?

# Question and Answer

**Operator**

[Operator Instructions] We will now take the first question from John Hecht from Jefferies.

**John Hecht**
*Jefferies LLC, Research Division*

Congratulations to Tim on the CFO designation. The first question is, you guys mentioned improvement of kind of demand activity starting a few weeks back. You also talked about having traffic counters installed. I mean do you have any stats around kind of the momentum just to give us a sense for the recovery and how -- the cadence of the recovery and how it might look?

**Jason A. Kulas**
*President, CEO & Director*

Sure. I'll give you some detail on that. So on the traffic counters, those have just recently been installed, and we're establishing baselines. And I think there's more to come on that in the future, particularly around, as we mentioned, the digital initiatives and marketing campaigns and the effectiveness of those and being able to measure them, also looking at capture rates and those kinds of things.

On the PLO, it's interesting because we did see PLO continue to decline through mid-April, but we started to see it turn around beginning in mid-April. So -- and this is speaking of the U.S. In Mexico and at GPMX, we actually saw an increase from the beginning of March to the beginning of April, marginal increase in both of those parts of the business. In the U.S., we're down very slightly from March to April, but we're down less than we were in mid-April. So that turnaround started midway through the month and started going the other way, which is a really encouraging sign.

Another aspect of this that we spent a lot of time looking at, obviously, is just our new loans made in both dollars and transaction counts. If you look at where we are on dollars and transactions versus last year, across the board in the business at the end of April, we're significantly ahead of where we were. If you look at the very end of April this year versus the very end of April last year, the new loans made trends are much stronger.

We also, though, just for discipline, compare ourselves to 2 years ago because that's a more normalized level of operations that we want to get back to and beyond. We're still below that, but if you look at where we were at the end -- at the very end of March on those origination trends versus where we sit or we sat at the end of April, the gaps were a little bit smaller versus 2 years ago.

So all in, we're really seeing some encouraging signs for things starting to come back. And this is all, obviously, subject to how these additional stimulus actions have an impact. But what we're seeing in every case now is that when those things happen, they're temporary and demand comes back pretty quickly after they fade.

**John Hecht**
*Jefferies LLC, Research Division*

Okay. That's super helpful. And then you referred to some of this, but I'm wondering if you could give us maybe a little context of what's going on in LatAm versus U.S. I mean the U.S. clearly has some stimulus activity that logically can be crowding out loan demand for a period of time. But it looks like the PLO and so forth in the LatAm is off more than the U.S. And I'm wondering -- but you also cited that it might be recovering faster. So I'm wondering if you could just give some color there. Why do -- why are there differences? Why are the pressures or were the pressures in LatAm greater? And do you expect the recoveries to be similar?

**Jason A. Kulas**
*President, CEO & Director*

Sure. So first of all, if you look at the performance of U.S. versus Latin America, the story is much more about the performance of the U.S. and really exceeding our expectations. Some of that you can attribute to timing of stimulus versus what we expected. But a lot of it also can be attributed to just really good, solid operations and moving inventory and sales velocity in that first 90 days and just operating the business, again, very effectively.

We do have some differences between Latin America and the U.S. If you look at just activity levels, rates of vaccination, if you compare the percentage of people vaccinated in the U.S. versus across our Latin American footprint, it's significantly different, which is leading to lower levels of activity. And then also some of the dollars that go to people in the U.S. end up showing up in remittances.

But it's a similar story as kind of the mid-April comments I made, and it actually goes back a little [ farther ]. If you look at the last couple of months in Latin America, we've really seen things start to pick up, and we're pretty happy with what we're seeing. We still have a long way to go, as you pointed out. But these are -- if you look at the trends that we're seeing, the positive trends, combined with the demographic factors, the penetration of the pawn product in the different countries where we operate, we still believe that the future is extremely bright in Latin America, which is why you see us continue to invest there in de novo locations and those kinds of things. But there are differences, and we expect those to dissipate over time. But as it stands right now, the U.S. business is producing more than Latin America.

**John Hecht**
*Jefferies LLC, Research Division*

Okay. That's helpful. Last question is, obviously, good trends on OpEx. Is this quarter a good run rate? And I think you kind of mentioned that you would think some of the variable expenses start to move up as transaction counts move up. But are there any other moving parts there? Or any other opportunities that you see to continue to drive OpEx lower.

**Timothy K. Jugmans**
*Interim Chief Financial Officer*

We would think -- yes, we're still looking for more savings as we go. But we think we have found most of the low-hanging fruit and now we are just looking at trying to maintain those cost savings going forward and to keep those expense savings low. But as we said, those store expenses will slowly come back as that transaction volume increases?

**Operator**

We will now take the next question from Greg Pendy from Sidoti.

**Gregory R. Pendy**
*Sidoti & Company, LLC*

I just wanted to dig into the inventory turns, the jump from -- to 3.1 from 2.1. How much of that is just the reduction in aged inventory and leaner inventory levels overall? And what do you think a normalized level could be? I mean are we seeing the impacts of Lana, I guess, help your inventory turns and how should we be thinking about that?

**Jason A. Kulas**
*President, CEO & Director*

Yes. We're really excited about what we're seeing on that aspect of our business in both the U.S. and Latin America. So across the entire pawn business, we're seeing higher turns and a greater focus on turning merchandise in the first 90 days when it's -- where it's most economical for us to do that. Clearly, this situation that we've gone through with sales demand starting about this time last year has helped us work through some of the aged inventory we had.

But we also had what we call internally a new pawn operating model that lends itself to incentives being in place and operations being focused on continuing to manage inventory effectively to turn it faster, to have that velocity be high. And the result has been great to see. And we think that result is going to continue to drive positive results because at the store level, we're seeing -- at the store manager level, the store manager is able to see, if we manage it this way, there are a lot of other aspects of the business that benefit financially and otherwise.

So we would expect that we -- that this is not temporary, that we've achieved a much greater level of efficiency in our operations and how we manage inventory. That ratio of PLO to inventory is more in line with what we would expect to see going forward. Obviously, the challenge for us will be, as inventory increases along with pawn demand going up and that trending higher over time, we'll need to be as effective at higher volumes, but we really believe strongly that we've got a new operational focus in place that's going to lend itself to that.

So we actually think these pickups in the inventory turns are here to stay. We did mention that the sales growth profit margins are likely to fall back a little because they're extremely high right now. And as you go into a more normal part of the cycle where there's a little more negotiation, those will slip a little. But the turns and the progress we've made on those we expect to keep and we'd like to continue to build on.

**Gregory R. Pendy**
*Sidoti & Company, LLC*

Okay. That's helpful. And then can you just talk a little bit about the M&A in the U.S., given the market is very fragmented? Kind of was this a distressed opportunity just given what's going on in the pawn environment? Is that what you're looking for? And are there any meaningful changes that you see? Or is it still going to have to be kind of smaller-sized acquisitions in the U.S.? What are you seeing there?

**Jason A. Kulas**
*President, CEO & Director*

Yes. In the U.S., the opportunities do tend to be smaller. It's still a really fragmented market. This is just a broad number kind of a general number, but there's something like 5,000 owners and 10,000 pawn shops in the U.S. So it's extremely fragmented, a lot of mom-and-pops. And obviously, it takes as much time to do a small acquisition as it does to do a larger one. But at the same time, we're focused on all of them. I mean we are having really good productive discussions with opportunities of all sizes. But again, they do tend to trend smaller in the U.S.

And I wouldn't say that this is a distressed situation at all. People will sell for many different reasons. Sometimes it's generational handover. Sometimes they're just ready to retire and go fishing or whatever it may be. And we're having ongoing discussions to make sure that they know that we're here, and we want to pay a market price and get deals done and move quickly, still do our diligence and be effective but also move quickly. And we've seen a good reception from that.

We hope to continue in future quarters to be able to announce that we've had more success. This 11-store acquisition in Houston is, as I mentioned, a really good sign that our efforts are paying off. But as you know, the M&A business is choppy and things happen when they happen. But we're really excited about the one we just did.

**Gregory R. Pendy**
*Sidoti & Company, LLC*

Okay. Great. And then it's been a while since, and I don't know if it's coming, but since we've seen any inflation, and you've mentioned kind of a pickup in PLO demand, maybe more on a sequential basis. But is there any impact you think from, say, higher gas prices that might be impacting demand a little bit, helping it to the positive side? And is there any context you can put on the environments of a pawn operator under a growing inflationary environment?

**Jason A. Kulas**
*President, CEO & Director*

So you bring up gas prices. Gas prices are up 63% today versus where they were this time last year. So that's a considerable increase in kind of an out-of-pocket expense that most of our consumers are incurring. You see it in other areas as well. I mean this has been a big topic of discussion this week in the markets. Inflation, is it transitory or not and those kinds of things. Building materials, consumer staples, consumer discretionary goods. Prices for things are going up. And it's interesting because the balance of that on the other side of it is unemployment is much better. It was almost 15% last April and now it's back down to 6%, not where we were at the beginning of 2020, but still really strong relative to where we were. Consumer confidence is high. The average hourly earnings are now back to above precrisis levels.

So the consumer sits in a pretty good position, which probably lends itself to less of a need for the government to intervene as much going forward in the future. But also offset by the fact that with some of these inflationary factors creeping in, what you would typically see in a market that's sort of operating on its own is, that kind of an environment would drive more needs for short-term cash. So the pawn business typically does well in all parts of an economic cycle, but it does better as prices are going up and things tend to be incrementally more distressed. So you would expect over time. If these inflationary trends are not transitory, you would expect that to drive more pawn demand and for that to benefit our business.

**Operator**

That will conclude today's question-and-answer session. I will now hand back to Jason Kulas for closing remarks.

**Jason A. Kulas**
*President, CEO & Director*

Thank you, everyone, for your time this morning, and we hope everyone has a great day.

**Operator**
Thank you. That will conclude today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect.