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Q3 2022 PROG Holdings Inc Earnings Call

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PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the PROG Holdings Third Quarter 2022 Earnings Conference Call. (Operator Instructions) I would now like to hand the conference over to your speaker today, John Baugh, Vice President, Investor Relations. Please go ahead.

John Allen Baugh ***PROG Holdings, Inc. - VP of IR***

Thank you, and good morning, everyone. Welcome to the PROG Holdings Third Quarter 2022 Earnings Call. Joining me this morning are Steve Michaels, PROG Holdings' President and Chief Executive Officer and Brian Garner, our Chief Financial Officer.

Many of you have already seen a copy of our earnings release issued this morning, which is available on our investor relations website, investor.progholdings.com. During this call, certain statements we make will be forward-looking including comments regarding our expectations related to the benefits of our lease decisioning adjustments on delinquencies, write-off levels and our accounts receivable provision; Progressive Leasing's write-off levels for full year 2022; our ability to convert additional retail partners from our pipeline; the strength of our balance sheet going forward; and our revised 2022 outlook.

I want to call your attention to our safe harbor provision for forward-looking statements that can be found at the end of the earnings press release that we issued earlier this morning. That safe harbor provision identifies risks that may cause actual results to differ materially from the expectations discussed in our forward-looking statements. There are additional risks that can be found in our Annual Report on Form 10-K for the year ended December 31, 2021, which we encourage you to read.

Listeners are cautioned not to place undue emphasis on forward-looking statements we make today, and we undertake no obligation to update any such statements. On today's call, we will be referring to certain non-GAAP financial measures including adjusted EBITDA and non-GAAP EPS which have been adjusted for certain items which may affect the comparability of our performance with other companies.

These non-GAAP measures are detailed in the reconciliation tables included with our earnings release. The company believes that these non-GAAP financial measures provide meaningful insight into the company's operational performance and cash flows and provides these measures to investors to help facilitate comparisons of operating results with prior periods and to assist them in understanding the company's ongoing operational performance.

With that, I would like to turn the call over to Steve Michaels, PROG Holdings' President & Chief Executive Officer. Steve?

Steven A. Michaels ***PROG Holdings, Inc. - CEO, President & Director***

Thank you, John, and good morning, everyone. I appreciate your being with us today as we discuss our third quarter results and update you on our business. I would like to begin by highlighting the progress we have made to mitigate some of the impacts of the significant macroeconomic headwinds we face.

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I'll start with the actions we have taken to strengthen the quality of our portfolio.

As we mentioned last quarter, during Q2 we took decisive, timely action around decisioning to address the trends we saw in the performance of our lease portfolio. The second quarter's write offs were 9.8%, well above our 6% to 8% targeted annual range, a reflection of the continuing economic pressures being felt by our customer. Our attention to early indicators of payment performance, and the decisive steps taken to impact the short duration portfolio have quickly benefitted overall portfolio health as can be seen by the 7.2% write-offs for Progressive Leasing for Q3, and in the improved profitability from last quarter.

Based on the current performance of the lease pools originated since our Q2 tightening efforts, we have not found it necessary to do additional tightening. However, we continue to monitor early indicators of pool performance, and we believe that we are still on track to achieve our goal of ending the year with write-offs near the high end of our 6% to 8% targeted annual range.

Another item we are controlling tightly are SG&A expenditures, given the top line headwinds. As we mentioned on the Q2 call, we have meaningfully reduced our level of spend. These reductions were aimed at driving efficiencies across the organization and aligning servicing costs with our latest expectations around GMV and revenue. For the third quarter, SG&A as a percent of revenue for Progressive Leasing was 12.4%, down from Q2 levels of 13%, resulting from our focus on improving efficiency and rightsizing SG&A across the organization.

The combination of these improvements in write-offs and the cost reduction actions we have taken were the primary drivers for Progressive Leasing's strong increase in adjusted EBITDA margins from 8.1% in Q2 to 11.3% in Q3. We are pleased that our adjusted EBITDA margins in Q3 were more consistent with our historical targeted ranges despite the broad-based inflationary pressures on costs. I would further point out that we achieved these margins while still investing in several key growth initiatives that we believe put us in the best position to capture the unserved market that remains.

With respect to progress on our growth initiatives, we have added approximately 60 new e-commerce retailers to our platform year-to-date, and we remain on pace to add more than a dozen more in the fourth quarter. These new partners will enable us to participate to an even greater degree in the continued expansion of online LTO. Our GMV within the online channel continues to grow versus brick and mortar, as e-commerce accounted for 16.5% of total Q3 GMV compared to 14.5% for the same period last year.

Our technology teams continue to deliver on our promise to develop products that enhance the experience for our retailers and customers. We have collaborated with partners on a number of product innovations designed to increase balance of share while continuing to provide easy integration and interactions for retailers and increased flexibility for customers.

Constructive conversations with potential new retail partners are ongoing. We firmly believe that this difficult retail environment is more conducive for us to connect with retailers whom we believe can benefit from our flexible payment solution, and we remain optimistic about converting more of our pipeline over the next several years.

Our progress on portfolio health, cost structure and key growth initiatives have mitigated some of the significant headwinds we continue to experience from the macroeconomic backdrop. We saw weak consumer demand during the quarter across most of our retail verticals, including with the majority of our key partners. In our addressable categories, retail traffic remains down, and we saw a number of large partners post double digit negative comps in these categories. Furthermore, the inflationary pressures being felt across the country are disproportionately impacting our customer, creating softness in our overall top line trends. Despite this, we were able to continue to increase our balance of share with a number of key partners.

While these challenges in the operating environment are not exclusive to us, they represent the primary driver for Progressive Leasing's negative 11.3% GMV comp in the period, as the spending of the credit-challenged consumer shifts away from our primary categories. GMV was also negatively impacted by our recent tightening of our lease decisioning, as I previously mentioned, and as we discussed on our Q2 call.

Finally, as data for upstream credit providers' 2022 origination pools becomes available, we expect the increases in delinquencies

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recently reported across most FICO bands to continue. While we have not yet seen meaningful tightening in the credit stack above us, these upstream delinquency increases historically precede such tightening, and we anticipate that, ultimately, that tightening would lead to the widening of the top of our application funnel that we've been discussing for several quarters.

As a result of the continued challenging operating environment, we have lowered our full year 2022 financial outlook, as shown in this morning's earnings press release.

As we have stated previously, while not a direct read through, our GMV production is not immune to the double-digit declines that some of our retailers are experiencing. Nonetheless, we believe our focus on executing on initiatives to increase our balance of share with key retailers, continued technological innovations and additional pipeline conversions will help us mitigate some of those headwinds in the near and intermediate terms.

Looking forward, we expect Q4 will be challenging on the GMV front and will likely come in similar to Q3's year-over-year percentage decline. We also expect write-offs to remain similar to Q3 levels.

Our capital priorities remain unchanged. During the third quarter, we repurchased 588,000 shares and have reduced our outstanding share count by 27% since the beginning of 2021. We ended September with a cash position of $222 million. We believe the capital we generate will continue to allow us to reinvest in the business and maintain a strong balance sheet, even with an uncertain economic backdrop.

During the quarter, we significantly improved our portfolio health while rightsizing our cost structure and remaining focused on technological innovations and pipeline conversions. As we look ahead, we expect to continue managing these areas efficiently and within targeted annual ranges to benefit us as we enter 2023 and going forward.

I'll close with emphasizing the strength of our business model. Even in a challenging environment with negative GMV growth, we have demonstrated our ability to manage the portfolio effectively, create efficiencies within our cost structure and generate significant cash flow in the process.

Finally, I want to reiterate my appreciation for the teamwork of all PROG employees as we continue to help consumers and retailers navigate this difficult environment.

I'll now turn the call over to Brian for more detailed look at the quarters' financials. Brian?

Brian J. Garner ***PROG Holdings, Inc. - CFO***

Thanks, Steve, and good morning. The third quarter's financial results reflect the impact of the challenging operating environment, mitigated to a degree by the actions we have taken reducing write-offs and SG&A spend at our Progressive Leasing segment. During Q3, we saw adjusted EBITDA and adjusted EBITDA margins improve as a result of the actions we took, while a challenging retail environment continues to negatively impact top line metrics.

Q3 GMV for the Progressive Leasing segment was down 11.3% year-over-year, driven primarily by macroeconomic factors, including a double digit year-over-year decline in addressable categories at many of our retailers and our tighter decisioning, partially offset by increases in our balance of share at many key retail partners.

GMV headwinds in the quarter negatively impacted revenue, and we believe will continue to do so in the coming quarters. As we exited the period, our gross leased asset balance was up 3.3% year-over-year, a deceleration from the 12% growth reported for the end of the second quarter, which was primarily driven by the impact of declining GMV on portfolio size.

Progressive Leasing's revenue was $606.6 million in the quarter compared to $635 million in the year ago period, a 4.5% decrease. The accounts receivable provision, which is a direct reduction to revenue, remains elevated from historical levels. As you'll see today in the company's 10-Q, this provision increased to $104.3 million for Q3 of 2022 from $61.5 million for Q3 of 2021. The increase in the AR

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provision reflects higher delinquencies year-over-year. However, as the full benefit of our tightening efforts impact our portfolio, we expect to see these delinquencies and the A/R provision trend closer to pre-pandemic levels.

Progressive Leasing's Q3 gross margin was 30.3% versus 31.4% in Q3 of 2021, primarily a result of the higher accounts receivable provision partially offset by lower 90-day buyout activity.

SG&A for the Progressive Leasing segment was $75.2 million or 12.4% of revenues versus $80.2 million or 12.6% for Q3 of 2021, a decrease of $5 million. This decrease reflects the cost reduction actions we discussed in Q2 as improved efficiencies and an effort to rightsize our cost structure resulted in lower SG&A.

Progressive Leasing's write-offs were $43.5 million, 7.2% of revenues, compared to $34.2 million or 5.4% of revenues in the year ago period, as we continue to compare against the stimulus-aided period last year. Write-offs declined from the 9.8% level we saw in Q2, driven by our tightening efforts last quarter. As we've mentioned, our annual target for write-offs is 6% to 8%, and we expect to be near the high end of this range for the full year 2022.

Adjusted EBITDA for the Progressive Leasing segment in the third quarter was $68.4 million compared to $88.4 million in the same period of 2021. This decrease is a reflection of the difficult comparison to the stimulus-aided period last year, and the current macro headwinds. I'll note that adjusted EBITDA for the Progressive Leasing segment improved meaningfully, from $51.2 million in Q2 to $68.4 million in Q3, and margins improved from 8.1% in Q2 to 11.3% in Q3, driven primarily by the improvements in write-offs and SG&A.

Pivoting to consolidated results. Q3 revenue for PROG Holdings was $625.8 million compared to $650.4 million in the year ago period, a 3.8% decrease. Adjusted EBITDA for Q3 was $65 million or 10.4% of revenues, compared to $93.6 million or 14.4% of revenues for the stimulus-aided third quarter last year. We generated $127.4 million of cash from operations in Q3, which is net of the working capital required to fund GMV. As a reminder, we typically have net cash outflows from operations in the Q4 period as a result of funding seasonally high GMV.

Our Q3 GAAP diluted EPS was $0.32, and our non-GAAP EPS came in at $0.68. We had $600 million of gross debt and $222 million of cash at the end of the third quarter and a net leverage ratio of 1.49x trailing 12-month adjusted EBITDA. We also ended the period with $350 million of availability under our undrawn revolving credit facility.

During the third quarter, we repurchased 10.9 million dollars of our outstanding common stock at an average share price of $18.52. At the quarter's end, we had $373.5 million remaining under our $1 billion share repurchase program.

Finally, as Steve mentioned, we have lowered our full year 2022 financial outlook to reflect the challenges we are currently experiencing around the macro environment. Since our Q2 earnings call, our expectations around GMV have been adjusted downward as our customers deal with the impacts of inflation. We also saw weaker-than-expected customer payment behavior on leases originated prior to our Q2 tightening efforts, which is reflected in our provision for accounts receivable. As we enter 2023, and more of the portfolio is concentrated in leases originated after our Q2 tightening, we expect this provision will trend towards pre-pandemic levels.

Our updated fiscal year 2022 outlook is as follows: Revenues in a range of $2.58 billion to $2.59 billion, adjusted EBITDA between $235 million and $240 million, and non-GAAP EPS of $2.32 to $2.38.

In summary, we are encouraged by the performance of our lease pools originated after the Q2 tightening, which helped deliver the Q3 write-offs of 7.2%. We are also encouraged by the improvement of our leasing segments' adjusted EBITDA margins and expect to see a similar benefit in Q4, thanks to the continued hard work and effort of our teams.

With that, I'll now turn things over to the operator for the Q&A portion of the call. Operator?

QUESTIONS AND ANSWERS

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Operator

(Operator Instructions). Our first question comes from Kyle Joseph with Jefferies.

Kyle Joseph ***Jefferies LLC, Research Division - Equity Analyst***

Just on GMV, obviously, it decelerated quarter-on-quarter. Just trying to wrap my arms around how much of that was incremental macro pressure versus underwriting changes? Or I guess another way I could ask would be what was the date the underwriting changes were specifically made in 2Q? And how much of an impact did they have in 2Q versus 3Q?

Steven A. Michaels ***PROG Holdings, Inc. - CEO, President & Director***

Kyle, this is Steve. So we made underwriting changes throughout Q2. We made some in early May, late May, and then in June again. So it's difficult to parse out the impacts in Q2. Obviously, they were in full effect throughout all of Q3. And as you think about kind of the GMV pressures, it's really 2 headwinds and the tailwinds that have been around all year because we made some other small tweaks to decisioning back in February and March as well. So you've got the macro weakness. We've seen application volume, which is kind of a proxy for consumer demand in our retail partners, be down in the in-store channel and flat to slightly up in the online channel.

But because online, we have lower approval rates and lower conversion rates due to the well-known kind of fraud from an approval rate standpoint, but also lower purchase intent online, losing an app in-store has a bigger impact on funded GMV than losing an app online. So it's really been -- it's been consumer weakness from an app standpoint along with our decisioning posture, offset slightly by higher ticket.

So we have seen about a 4.5% to 5% increase in ticket this year due to basically just inflationary pressures in the retail environment. So as you think about year-to-date, it's predominantly consumer weakness and decisioning offset by ticket. Q3 more specifically was probably more than 50% decisioning, then you had maybe a 1/3-ish from consumer weakness also offset by ticket.

Kyle Joseph ***Jefferies LLC, Research Division - Equity Analyst***

Okay. Got it. Very helpful. And then as you're thinking about the prospects for a GMV recovery, I know you guys mentioned the supply of credit, I haven't seen any tightening yet there. But at least more on the demand side, is there -- is it just a function of if inflation gets under control? Is it, do we have to lap some certain comps? Or do we need to move away from the big product cycles we saw in 2020 and 2021, but just how you're thinking about potential catalysts for consumer demand to recover?

Steven A. Michaels ***PROG Holdings, Inc. - CEO, President & Director***

Yes. The demand side is obviously more difficult to predict. There's always going to be a break-fix cycle. But the farther we get away from the nesting and the stay-at-home demand pull forward in the high liquidity environment of the pandemic, obviously, the better it is for demand. We're certainly not expecting some massive rebound in 2023 from a retail standpoint, depending on what your forecast is for the macro and whether we're going into a recession or not.

But we do continue to be encouraged by our ability to execute on certain roadmaps that we have with retailers that can allow us to increase our balances of share even in the face of headwinds from a demand standpoint. And we've done some of those this year. We've talked about them previously, whether it be full e-comm integrations or waterfalls in the credit stack or continued marketing or go POP in the stores. So it's just -- we're certainly facing a difficult retail environment.

And as I've said a number of times, it's not a direct read-through to us because we do have ways to mitigate, but we're not immune to it. So it's certainly caused some pressures on GMV. And as we said in the prepared remarks, we're expecting a similar result in Q4 just because of all the pressures that we talked about and the fact that the all-port holiday season is still in front of us, and it remains to be seen how it's going to play out.

Kyle Joseph ***Jefferies LLC, Research Division - Equity Analyst***

Got it. And then one last one for me. I've followed Progressive for a long time. Obviously, this is probably one of the most -- or is the most challenging environment I think the business has faced. But in consideration of that, have you seen any impact on the competitive environment? Obviously, you guys are one of the biggest in the space. I would imagine some of the smaller competitors are feeling the

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impact even more. And are there any potential opportunities as a result of that in terms of winning partners or partners with competitors, et cetera, how you're thinking about the competitive dynamics, given the tough backdrop?

Steven A. Michaels ***PROG Holdings, Inc. - CEO, President & Director***

Yes. I mean it is a tough backdrop, but it also gives us a chance to demonstrate the strength of the business model. And our -- one of the things that has shown through this quarter is our ability to control the portfolio, which we've been talking about for a long time and have now proven it. But from a competitive standpoint, from a growth standpoint, I mean, obviously, the biggest size of the price for us is still the unserved panel. So we're going out there and having fruitful and constructive conversations with retailers that don't have LTO. We obviously are highly focused on taking share from competitors as well and taking advantage of opportunities if somebody either has a funding issue or is not living up to the promise to that retail partner.

But as we've said for years, it's a very choppy competitive environment, especially in the regions. And so it's like 2 steps forward 1 step back, in that you can win a regional player from a competitor, but then you turn around and find out that somebody has come in and taken a little bit of business from you in a different one. We're making progress there. We've got a great regional or SMB team, and they're doing really well out there, and Progressive continues to show its leadership position in the industry and how we can win. So we're encouraged about our ability to continue to grow that way, which can help mitigate some of the like-for-like or same-store pressures that we're feeling from a GMV standpoint.

Operator

Our next question comes from Jason Haas with Bank of America.

Jason Daniel Haas ***BofA Securities, Research Division - VP***

So it looks like from the guidance, there's going to be better flow-through from GMV into revenue in the fourth quarter. I don't know if that's a reflection of lower accounts receivable provision. And maybe just given the decisioning, it's better quality GMV that you're bringing in, better collectability. I know those are tied together, but just curious if you could talk about that dynamic. And if so, if we should continue to see that through the next 4 quarters or so into next year?

Brian J. Garner ***PROG Holdings, Inc. - CFO***

Jason, it's Brian. Yes, the accounts receivable provision is a direct reduction of revenue, as I know you understand. And the dynamics at play or the decisioning change we made in the first half of the year continue to work their way through. And at this point in time, if we think about our accounts receivable provision, it's still heavily weighted towards the old portfolio, call it or the pre-2Q originations. And so what's going to happen is that kind of moves towards our new decisioning posture. You are going to see some relief on that accounts receivable provision on a go-forward basis. I think you'll see it here in Q4 step down a bit. And so that's part of the dynamic that I think you're seeing.

Jason Daniel Haas ***BofA Securities, Research Division - VP***

Got it. That's great to hear. In terms of the gross margin, I'm calculating it for the Progressive Leasing segment, and we're still running quite a bit, I think it's maybe, I don't know, 200 bps or so below what you were doing in 2019. So just curious if you could talk about why that gross margin is lower. I don't know if it's a function of the environment is more competitive. Are you shifting to large national retailers that maybe have a different pricing structure? And is it possible that we could get back to more like 2019 levels? Or is this the right run rate to use going forward?

Brian J. Garner ***PROG Holdings, Inc. - CFO***

Yes. I would say at the top of the list of factors impacting that gross margin is this accounts receivable provision. You've seen how much it's increased from a year-over-year perspective. It's up, I think, roughly $43 million year-over-year and from an absolute dollar perspective, this is a percentage of, call it, gross revenue before that provision. It's well elevated from historical levels. So I think the key to getting back to gross margins that are familiar pre-pandemic, it's going to be seeing that accounts receivable provision come down. That's going to be a function of continuing to see delinquencies come down. And that's the, I think, the path forward.

The next biggest drivers are just what's happening from a disposition standpoint. And we actually saw 90 days come down a little bit

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year-over-year as we use our comp against a highly liquid stimulus-aided period last year and so that's actually worked in as a tailwind. So there's not been significant composition changes in terms of retailers or retail behaviors that rise to the top of the list or as the biggest factors. We need to turn over the accounts receivable dynamic, and we expect that will move to a more favorable spot starting here in Q4, and we'll work to make that continue.

Operator

Our next question comes from Anthony Chukumba with Loop Capital.

Anthony Chinonye Chukumba ***Loop Capital Markets LLC, Research Division - MD***

So as I look at your revised guidance, so you brought down the midpoint of revenues by about 2%. But you brought down the midpoint of your EBITDA guidance by about 10%. And if I look at the implied EBITDA margin, it goes from 10% to 9.2% at the midpoint. So I guess I was just wondering what accounts for that, particularly given the fact that you said you're taking costs out, and it sounds like the lease merchandise write-off rate has stabilized. So I guess that was my first question.

Brian J. Garner ***PROG Holdings, Inc. - CFO***

Yes, there's 3 moving parts that I'll just offer, I think. If you think about a Q4 period, you do have the highest GMV generation. Expected with that, you've got some variable costs and transaction-related costs that flow through so that aren't going to -- the GMV isn't going to translated to revenue. So that's probably the biggest piece I'd point you to. I would just expect, while we made a ton of progress here in Q3 on SG&A, I'm proud about where we've been from an execution standpoint on that cost reduction plan, 12.4% is a number that is more reflective of where we're at before we became a public company in 2019. And so we've done a lot of work there, but there's still going to be, I expect to, tick up probably in SG&A into Q4 with just those transaction-related costs with a higher GMV volume coming in, in Q4 than we expect relative to Q3, and that's going to put a little bit of pressure is our expectation.

Anthony Chinonye Chukumba ***Loop Capital Markets LLC, Research Division - MD***

Got it. That's helpful. And then you talked about the fact that there's obviously a lot of weakness with your retail partners, and that's consistent, obviously, with what we're seeing out there. But I guess the -- it's a double-edged sword, right, because I think that would help you from a retail partner pipeline perspective. So I was just wondering if you could give us any update in terms of your retail partner pipeline.

Steven A. Michaels ***PROG Holdings, Inc. - CEO, President & Director***

Yes, you're right on the -- in a tough retail environment, Anthony, that's when our offering of having a fully developed finance stack in all retail should be more acceptable and more conducive for those sales. So we're having -- we don't obviously talk about specific names in the pipeline, but this is the environment where we think that we have the ability to make hay. Obviously, we're right upon code freezes for retailers for the holiday season. So it doesn't go quiet because we're still having great conversations, but we're not really actively with hands-on keyboards. But it is a big opportunity for us over the next 1 to 3 years to convert the pipeline, and we're encouraged about our ability to continue to do that.

Operator

Our next question comes from Brad Thomas with KeyBanc.

Bradley Bingham Thomas ***KeyBanc Capital Markets Inc., Research Division - Director & Equity Research Analyst***

First, just with respect to the current underwriting and decisioning levels. I was hoping for just perhaps a little bit more perspective on where you are from a historic perspective. Obviously, you did some tightening in 2Q. But can you help give us some context for if you look back over maybe the last 10 years, where you stand on a looser versus tighter perspective?

Steven A. Michaels ***PROG Holdings, Inc. - CEO, President & Director***

I mean 10 years is a long time, and there's been just kind of massive changes to our decisioning sophistication over that time, and there's been channel shift. So what I'll say is just I'll give you absolute approval rate changes like I did last quarter. So for the -- we're actually fairly flat when you talk about year-to-date. So we're down 200 bps year-to-date for '22 versus '21, but only about 100 - down 100 bps versus 2019 kind of pre-pandemic.

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Now if you're talking about just Q3 after we did the decisioning changes, the material decisioning changes in Q2, we're down 750 or so, 800 basis points from 2021. Obviously, 2021 was (technical difficulty) were elevated approval rates because of the payment performance and the stimulus-aided, just environment we are in, but we're down about 225 basis points from 2019.

Now, these are weighted -- approval rates weighted by channel. So if you were to normalize for channel and there's a pretty material difference between approval rates online versus approval rates in-store, not even -- not to mention the conversion rates. But if you were to normalize by channel back in 2019, we're fairly consistent with 2019 approval rates if the apps were coming from the same channel. If you go back previous to '19, back to kind of the '15 to '18 period, I was -- I don't have the data in front of me, but I would say where approval rates were probably higher just because we've found ways through our decisioning models to combine for those next approvals that can be profitable for us.

Bradley Bingham Thomas ***KeyBanc Capital Markets Inc., Research Division - Director & Equity Research Analyst***

Yes. That's really helpful perspective, Steve. And then I was hoping to ask a question just about EBITDA margins and maybe some initial thoughts as you think out 2023. Our view on Progressive is that you've got tremendous opportunity to be a highly profitable business and a lot of that just comes with getting your underwriting aligned with the consumer backdrop that you're a part of. And obviously, you've taken a lot of that medicine earlier this year. We're also seeing a difficult retail environment, though.

And so I guess as you think out to next year, can you help us think about those elements of getting the underwriting more aligned with how the consumer actually is able to pay coupled with the level of investment that you think is warranted in the business in this perhaps more challenging environment and your optimism for margins for next year?

Steven A. Michaels ***PROG Holdings, Inc. - CEO, President & Director***

Yes. From the underwriting standpoint, I mean, if you look at the pools originated post kind of June 30 or July 1, we're where we expect to be or want to be with our historical 6-plus year - 6% to 8% targeted annual range from a loss standpoint. Obviously, we're continuing to watch it. And if unemployment starts to tick up, if we need to make or find it necessary to make additional decisioning changes, we will do that. And as you have seen, they can have fairly quickly -- quick impacts on the portfolio. So as we flip the calendar page into 2023, the portfolio will be majority -- I mean a heavy majority comprised of leases originated post 07/01 of '22. It won't be fully there, but it will be almost there.

So as we think about the portfolio performance and portfolio health going into '23, we feel good about where we are. Clearly, the risk is further deterioration in the economy and potential unemployment, although I would say that as a green shoot to that, that usually and should result in the credit stack above us tightening as we've all been predicting and waiting for several quarters that should open up the top of the application funnel for us, which can bring in, on average, better quality applicants into our funnel without us even making any decisioning changes.

So to repeat or in summary, the portfolio is in good shape moving forward for the leases post 07/01, and we have not found the need based on our weekly and daily monitoring to make additional changes since then, but we stand ready to do it if it's necessary. So from a health standpoint, that will be a tailwind for us for 2023 just because we won't be having these higher write-offs and higher bad debt expense or at least our AR provisioning expense. From a -- we talked about pipeline, so that's an encouragement. I'm not sure how much of an impact that will have in actual 2023 GMV, but it could impact future years.

And then from a growth standpoint, we look to be able to continue our productivity within our existing doors and hopefully add some more. But you mentioned it's a profitable business. It is a profitable business. It's maybe less profitable this year than it has been historically, but it's a profitable business that generates a significant amount of cash flow in all cycles. And as we -- once we see that widening at the top of the funnel, that will be a removal of a headwind and hopefully, a decent sized tailwind for us to continue to deliver those historical margins and dollars.

Operator

Our next question comes from Bobby Griffin with Raymond James.

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Robert Kenneth Griffin ***Raymond James & Associates, Inc., Research Division - Director***

First, I just wanted to circle back just on the OpEx side of the business. Steve or Brian, has the fixed variable nature of this business changed over the last 12 or 18 months with some of the investments? I'm just trying to kind of connect the dots of, if GMV is down again in 4Q, why aren't we seeing OpEx kind of flex down with lower transactions or anything like that versus tick up as your earlier comments said sequentially?

Brian J. Garner ***PROG Holdings, Inc. - CFO***

Yes. Just to add some color there. The tick up is from a Q3 to a Q4 commentary. There's -- and that's not unusual when you look at seasonality historically. You've got a higher GMV. Q4 is your highest GMV generative period, and so that's going to step up from Q3 is our expectation. And so that's going to be part of the cost driver. The fixed variable nature of the business has largely remained unchanged over the years. Obviously, we have some public company costs that we layered on post-split. Those aren't -- they're probably in the range of $10 million to $15 million of our total spend. But generally speaking, we remain a very highly variable cost structure. And that's why we were able to -- we don't have long-term fixed obligations that kind of saddle us for multiple years.

That's why we were able to quickly demonstrate the improvement in SG&A in the Q3 time frame from last quarter, as Steve mentioned in his prepared remarks. And so it's one of the things that with GMV, you're going to see some GMV moves sequentially, from a quarter-over-quarter standpoint, you see SG&A move, but it still remains largely within our control on a go-forward basis. And so as Steve comments about margins and our ability to maintain margins, that's part of the strength of the model is our continued control over that. So it was really a commentary on just the expectation that SG&A as a percentage of revenue is generally higher in Q4, and that's what I'd expect to see here, especially given kind of the way we're scheduling our GMV.

Robert Kenneth Griffin ***Raymond James & Associates, Inc., Research Division - Director***

Okay. So maybe take it a step further. I mean like if you back out the restructuring, you back out the impairment, we're looking at maybe roughly $100 million in SG&A this quarter, ex D&A. So if we have a couple of more quarters as we go into 2023 and the GMVs face pressure, we'll see that $100 million flex down in dollar terms? Or is there like a level of investments that's going in there that we're not seeing the flex down in dollar terms? So that's where -- I mean it just looks like it's holding roughly at $100-ish million or maybe ticking up.

Brian J. Garner ***PROG Holdings, Inc. - CFO***

Yes. Without giving too much color into 2023, I guess I would say that generally, I'd expect Q1 SG&A dollars or percentage to - as a percentage of revenue to relieve a bit from Q4 levels. But again, we're not committing to any 2023 metrics just yet. There's ongoing planning cycle. But I think you're thinking about it right. You generally have just a bit of a tick up here in Q4.

Operator

Our next question comes from Vincent Caintic with Stephens.

Vincent Albert Caintic ***Stephens Inc., Research Division - MD & Equity Research Analyst***

Just 2 follow-ups on earlier questions. So first on the write-off rates. It was very nice to see the write-off rates decline quarter-over-quarter. And I think you're the only one of the lease-to-own guys to show that good result. So from the adjustments, the tightening that was made in the second quarter, is there still more room for that write-off rate to decline, so we haven't seen all the improvement yet in the third quarter?

And then if you could maybe talk about the tightening that you've done, what sort of macro backdrop is built into that? Or said another way like what would it take in order for that write-off rate to potentially perhaps get worse?

Steven A. Michaels ***PROG Holdings, Inc. - CEO, President & Director***

Yes, I'll start, Vincent. This is Steve, and Brian can chime in. But the way that the portfolio works, there's 2 different dynamics when it comes to portfolio performance. And one is the write-offs, which is our publicly reported metric. And that one moves more quickly because it's based on the book value of the inventory that we have out on lease. And then there's the AR provision, which is also publicly reported metric. But that takes a little bit longer to move through the system.

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So from a write-off standpoint, the post 07/01 lease originations are more of a story in Q3 than on the AR side. They will continue to become the story in Q4. But as we said in our prepared remarks, we're expecting write-offs in Q4 to be in the same neighborhood, similar range to Q3. And our goal from an annual standpoint is 6% to 8%. So we're not actually trying to drive write-offs down to 5% or even where they were during the pandemic. That's probably -- that's too tight of a posture. So we're expecting similar results in Q4, which we think will get us near the high end of our 6% to 8% annual range, which we're proud of, especially given the impact of earlier this year's performance on the portfolio.

What's built-in is we're basically tracking all of our early indicators, whether it be first pay balance or delinquencies or any of the other indicators that we have against our pre-pandemic pools because I don't remember the exact numbers in '18 and '19, but we delivered somewhere in the low 7s of write-offs in those years. And so that's kind of down the middle of the fairway of our 6% to 8% range. And if we can track on a weekly basis the same results as the pool matures, then we feel good about our ability to deliver those results. There's -- what's baked into it is kind of like the current economic backdrop, the inflation, the stressors on our consumer.

What's not baked into it is some material shift in unemployment. And the unemployment is also an interesting dynamic, right, because I expect unemployment to go up. But what are you hearing out there as far as layoffs? It's mostly in engineers and tech and Silicon Valley. It's not necessarily in hourly service workers and manufacturing. Now that may come, and we're braced for that, and we have our hands on the wheel to make adjustments.

But there still seems to be a shortage in those workers, and there have to be a decent amount of demand destruction in order for there to be material weakness in that end of the employment curve. I'm not saying it's not going to happen, but I'm saying that we're looking for it and embrace for it and can make adjustments. But we're tracking towards pre-pandemic. That's our guidepost, and we're feeling really good about where we are on the pools originated after 07/01.

Vincent Albert Caintic ***Stephens Inc., Research Division - MD & Equity Research Analyst***

Okay. Great. That's a lot of helpful detail. And then a follow-up. So great to hear that merchant engagement is increasing. Just wondering if you could update us on sort of the discussions you're having, in terms of the merchants that you are winning and the -- I know you've won 60 so far and another 12 this quarter. If there's any industries or bands that you're getting particular success with? And then also as we think about the fourth quarter and the holiday selling season, what sort of engagement are you getting in terms of marketing and promotional activity with the merchant?

Steven A. Michaels ***PROG Holdings, Inc. - CEO, President & Director***

Yes. So on the e-comm, we're excited about our e-comm activities. And if we add 75 or so new retailers in 2022, that's a -- we think that's a successful year. These are on the smaller side, obviously. They're not going to materially move the GMV, but they help us. If it's an e-tail-only retailer, that's great; if it's an e-comm flow for a brick-and-mortar retailer that we already serve, that helps us broaden and deepen the relationships. So we're pleased and excited with those with that progress.

And as it relates to the fourth quarter on larger merchants, as I mentioned, mostly, we have code freezes, but we're -- as far as industries, there's a lot of opportunity for us right down -- I guess industry is not the right word, let's call it, categories or verticals. There's a lot of opportunity for us right down the middle of the fairway. We'll look to expand a little bit here and there if it fits that mold of a bigger ticket item for a consumer, and we're definitely having conversations in that regard as well.

As it relates to the fourth quarter marketing, holiday season is going to be an interesting one. We're hearing from some of our retailers that they expect it to be a late-developing holiday season. And I guess the consumer has a lot of power in that because if the consumer says, "Hey, I'm going to sit on my hands and wait because I think there's going to be promotional activity or markdowns," but just the fact of them waiting causes the retailers to get concerned and create markdowns in promotional activity. So we're expecting the period on and around Black Friday through Christmas to be more heavily weighted than maybe even it is in normal years.

But in preparation for that, we've got a number of things that we're doing. PROG partnered with our retailers, co-branded marketing campaigns, daily deals in that partner week. We've also got a retailer adopting point-of-purchase material for the first time since we've

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been with them. So we're pleased with the fact that our retailers are trusting us and reaching out to us and collaborating with us on how to make the most out of our programs.

Operator

Our next question comes from Hal Goetsch with Loop Capital.

Harold Lee Goetsch ***Loop Capital Markets LLC, Research Division - SVP***

I got a question on the retailers that you've added maybe by -- not by name, but by cohort or the year they were added. And there's a mix of brick-and-mortar, and there's mix of e-commerce, you mostly mentioned the e-commerce merchants you've added for the year. And then you've also said later on the call that they have lower approval rates and generally lower take rates because the quality is not as good.

But could you show us some ideas on like the retailers that you added in 2018, '19, '20, '21, we're -- with the cohorts that were added during the pandemic, did they come on at much higher productivity levels than normal, and we're seeing that fall? How are the cohorts by year that are added acting if you could do that analysis, because it seems like you're adding merchants every year, every quarter, GMV is down because of -- and we're just trying to figure out like when things bottom up, you're going to have the up -- at the next upturn, you'll have more merchants doing more business, you'll come out of this with as a growth cyclical not just stay flattish here?

Steven A. Michaels ***PROG Holdings, Inc. - CEO, President & Director***

Yes. I'll try and tackle that one, and I'll start with the last part of your comment. Again, that's certainly our base case and our expectation that the broader we can widen the base, the more retailers and customers that we can add will create a better springboard, if you will, for when retail environment picks up and have that inflection point on growth.

Reverting back to the earlier part of the question, it's difficult to say. 2019, well, obviously, was a banner year for us. That's when we added Best Buy and Lowe's. We didn't like ramp -- so 2019 was a good year, but we didn't ramp productivity faster than we otherwise would have during the pandemic because we actually felt like during the pandemic, we had a headwind on GMV production because customers had so much cash they didn't rely on flexible payment options as much. They just paid cash at the point of sale. So it kind of was the COVID pause, if you will, from a -- we did find and we grew with those retailers. But I think all things being equal if we hadn't had COVID, we'd be further along with those retailers than we are now.

And then as it relates to -- I don't want to make it sound like I'm not interested in online applications because online applications, you can get them very quickly and they can be millions of applications and in-store, while they do have higher approval rates and higher conversion rates, it's a numbers game. So even with the lower approval rates and the conversion rates, the numbers can swamp the in-store over time as we broaden our base of e-commerce and e-tailers and as well as our interaction with our own digital platforms as it relates to Progressive Leasing e-comm and the PROG app.

So there is channel shift. We expect to continue channel shift, not only from the application side but also from the funded GMV side. We talked about growth there, up to 16.5% of our GMV was from the e-comm channel. So we expect that to continue. It's just difficult to go back to '17, '18, '19 and say what happened and what will happen. But I would just add with that is -- our goal and our objective is to get as many retailers as we can, even while retail business is soft, such that when we get into the next replacement cycle and get that inflection point up, we're starting from a much larger base.

Harold Lee Goetsch ***Loop Capital Markets LLC, Research Division - SVP***

Okay. You would say though then that the credit performance is a pretty big contributor to your earnings surge in late 2020 and 2021 then?

Steven A. Michaels ***PROG Holdings, Inc. - CEO, President & Director***

Are you talking about portfolio performance?

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Harold Lee Goetsch ***Loop Capital Markets LLC, Research Division - SVP***

Yes.

Steven A. Michaels ***PROG Holdings, Inc. - CEO, President & Director***

Portfolio performance, absolutely. Yes, absolutely, I mean, we've been targeting that 11% to 13% adjusted EBITDA margin for a number of years. And when the payment performance because of all the stimulus came through in '20 and '21, we had write-offs down in the 2% and 3% and 4%, and we were very clear that we were over-earning the model, at least in the growth phase that we expect that we're in. So 14% to 16% EBITDA margins was an out of target what we executed on. So we expect to kind of get back towards those ranges. This year has been a reset in the opposite direction.

Harold Lee Goetsch ***Loop Capital Markets LLC, Research Division - SVP***

And my last question is, would you say that with the credit underwriting you've done to date, the last tightening in Q2 and the performance you just put up in Q3 and then the speed at which the book turns over, would you say you're pretty set up to be in that 7% to 9% range go forward from here?

Steven A. Michaels ***PROG Holdings, Inc. - CEO, President & Director***

Are you talking about the write-off range? The 6% to 8% write-off range?

Harold Lee Goetsch ***Loop Capital Markets LLC, Research Division - SVP***

Yes. The write-off range, yes, basically the last range on a go-forward?

Steven A. Michaels ***PROG Holdings, Inc. - CEO, President & Director***

Yes, I think we feel good about where we are. I think we've proven and demonstrated our ability to influence the portfolio very quickly. And as the months turn and we turn into '23 and the portfolio was comprised of pools originated after the tightening, we would expect it to deliver performance within those ranges.

Operator

That concludes today's question-and-answer session. I will now turn the call over to Steve Michaels for closing remarks. Steve?

Steven A. Michaels ***PROG Holdings, Inc. - CEO, President & Director***

Yes. Thank you, everyone, for joining us today. We appreciate your continued interest in PROG. I just want to thank the team for really executing in a very difficult environment. Our goal is to make things easy for our retailers and our consumers, and we continue to do that. And this time and this choppy environment is when we become more important to both of those. So we look forward to continuing to deliver on that promise. We look forward to updating you next quarter.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.

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