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Q4 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 Fourth Quarter Earnings Conference Call. At this time, all participants are in listen-only mode. After the speakers' presentation, there will be a question and answer session. (Operator Instructions) Please be advised that today's conference is being recorded. I would now like to hand the conference over to your speaker today, John Ball, 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 Fourth 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 we expect from the three pillars of our strategy; our lease portfolio performance in 2023, including with respect to delinquencies and write offs; our GMV for 2023; and our outlook for the 2023 full year and first quarter.

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, 2022, which we expect to file later today.

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 you joining us this morning as we report our Q4 and full-year 2022 results as well as take this opportunity to provide thoughts on our initial 2023 financial outlook.

Last year was a challenging year for both our customers and merchant partners, and the combination of weaker-than-expected retail traffic and rising inflation pressures impacted our business. In response, we quickly adapted, balancing near term expectations against long term growth strategy, managing our portfolio, and right sizing our cost structure while still advancing key investments and

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initiatives.

Towards the end of the first half of the year, we enacted changes to our decisioning that continue to bolster our portfolio performance today. We substantially reduced our write-offs in the second half of the year, with Q4's 6.5% marking our low point for 2022, and I am extremely proud of our efforts that resulted in annual write-offs of 7.7%, which is within our targeted annual range of 6%-8%. We have a long history of managing our portfolio in various macro-environments and have not exceeded our targeted annual write-off range since we established that range in 2016. Entering 2023, we feel good about the health of our portfolio based on the decisioning changes made last year and the delinquency performance we have seen since that time.

Since the beginning of last year, our leadership team has continued to improve, with a number of key additions in technology, finance, and other critical areas. I believe that the experience and stability our executives and department heads offer, will provide the leadership necessary to successfully navigate this dynamic macro-environment.

Again in 2022, we executed multi-year renewals with a number of our top partners. These renewed and extended exclusivity agreements are recognition by our retail partners of the value they see in continuing to partner with Progressive Leasing. Despite stark declines across the retail landscape, our balance of share within leasable categories grew with nearly every one of our top accounts thanks to technological improvements, deeper integrations, a mix-shift towards e-commerce, and success with co-branded marketing campaigns. We believe our history of delivering value for our existing and new partners will continue to benefit our future growth.

In Q4, e-commerce as a percentage of Progressive Leasing GMV reached an all-time high of 20.4%. During the year, we saw a continued shift towards a more online or omni-channel shopping experience following the transition forced by the pandemic. As the largest e-commerce lease to own provider by GMV, the value in aligning our offerings with our customers' behavior is clear, and we remain focused on providing a range of customizable e-commerce integration options for our retail partners.

These accomplishments allowed us to operate more efficiently while continuing to support growth initiatives for both the short and long term, and we exited the year in a strong financial position despite the macroeconomic headwinds.

Our strategy remains centered around three key pillars -- grow, enhance, and expand. We believe these pillars will deliver growth and value for our shareholders.

First, we plan to grow GMV through strategic collaboration and marketing efforts with our existing partners. In addition, we remain focused on converting our pipeline of retailers into new POS partners, and our ability to maintain and strengthen new and existing relationships, including addressing the changing needs of our POS partners, is critical to the long-term growth of our business. We will also continue to expand our direct-to-consumer marketing efforts to attract new customers and drive more GMV through in-store and online retailers.

Second, we are investing in technology platforms that enhance customer engagement and simplify the lease application, origination, and servicing experiences. We are committed to providing our customers with transparency, flexibility, and greater choice on how and where they choose to shop, and we are enhancing and innovating our e-commerce capabilities to benefit existing and new POS partners and customers.

Third, we expect to expand our financial technology product ecosystem through research and development efforts and strategic acquisitions that we believe will result in a more loyal and engaged customer base. We will leverage our extensive database of lease agreements to offer current and previous customers products that meet their needs.

While Brian will get into more detail on our 2023 outlook, I'd like to summarize how we are thinking about the macro backdrop related to our positioning going into 2023. Due to continued economic pressures felt by our consumer, we believe there could be a delay in purchase intentions or a trade down to lower ticket items. Consumers' cash reserves are declining while credit utilization is increasing, and data show that customer liquidity stress is at the highest level in 3 years.

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Despite the challenging macro environment, our tighter decisioning posture has helped the portfolio recover, with leases originated in the second half of the year performing on par with pre-pandemic results. Portfolio performance metrics look strong entering 2023, with lower delinquency rates and charge-offs, which should improve gross margin year over year. While we are still early in the year, we are on track to achieve our annual write-off target of 6-8% of revenue yet again, based on the results we have seen year-to-date.

From a GMV standpoint, in addition to the consumer stress, potential declines in average ticket, and potential deferred purchases that I just mentioned, because of our tightening of lease decisioning in late Q2 2022, we expect GMV results to be pressured in the first half of 2023 as we comp against higher approval rates from last year. As we have discussed in the past, we believe we are a more valuable partner to retailers during tough retail environments and we look forward to helping our partners convert more traffic.

As you'll see in this morning's release, we also shared a view of how we expect Q1 to shape up in addition to providing our normal annual outlook. As we move throughout 2023, we plan to continue providing key current quarter metrics for greater visibility into how we believe the year will unfold.

As Brian will talk about momentarily, we ended 2022 with our gross leased assets balance, the driver of future period revenue, down 5.3% year over year. This decline, in addition to our first-half expectations around GMV, will weigh on our quarterly revenue comparisons, and we expect that these top-line headwinds, when coupled with factors such as wage inflation and continued investment in growth initiatives, will result in negative operating leverage.

Finally, during the year we purchased 8.7 million shares, which represents 15.5% of our outstanding stock, and we generated $242 million in cash flow from operations, illustrating our financial strength and commitment to returning value to shareholders. Our net leverage ratio at the end of Q4 was 1.8 times, which is still, in our opinion, within a comfortable range. We believe that the capital we generate in 2023 will continue to allow us to maintain a strong balance sheet, reinvest in the business, and return excess capital to shareholders.

In closing, I want to take a moment to thank our team for navigating through a challenging year by being adaptable and continuing to execute on our strategy. We controlled the controllable aspects of the business, and we head into 2023 with a healthy portfolio and an eye towards future growth.

I will now turn the call over to our CFO, Brian Garner, who will discuss our 2022 financial results and 2023 outlook in greater detail. Brian?

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

Thanks, Steve. Our fourth quarter results demonstrate our ability to remain nimble in a challenging macroeconomic environment by addressing financial drivers within our control. Our portfolio management and cost actions resulted in year-over-year Adjusted EBITDA growth in the fourth quarter despite a 5.3% decline in revenues, which, when combined with our materially lower share count, resulted in a 25.4% increase in non-GAAP diluted EPS for the quarter compared to Q4 2021. Our better-than-expected consolidated results were primarily driven by margin improvement at our Progressive Leasing segment, which had a Q4 Adjusted EBITDA margin of 13.6%, compared to 10.5% in the same quarter last year.

As indicated on prior calls, throughout 2022 we navigated quickly changing trends in customer payment performance. As cash reserves from stimulus subsided, delinquencies started to climb in the first half of the year, peaking at lease merchandise write-offs of 9.8% in Q2. Our continued investment in our data science teams coupled with our short duration portfolio allowed us to quickly reverse the write-off trajectory we saw in the first half, driving lower write-offs, higher margins, and increased profitability as we exited the year.

Moving to consolidated results. Consolidated revenues declined 5.3% in Q4'22, as the Company faced headwinds on GMV stemming from a more conservative decisioning posture year-over-year combined with softness in consumer trends for the categories we serve. As Steve mentioned, these factors drove a declining gross leased asset balance, and our accounts receivable provision remained elevated in comparison to pre-pandemic levels.

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Consolidated SG&A as a percentage of revenue was relatively unchanged from 14.8% in Q4'21 to 14.9% in Q4'22, though overall SG&A expense decreased by $4.4M year-over-year in Q4 as a result of the cost reduction actions taken in Q2.

Consolidated Adjusted EBITDA increased 3.2% to $74.4M in Q4'22 from $72.1M in Q4'21, driven primarily by improvement in gross margin at Progressive Leasing from a lower accounts receivable provision and declining 90-day buyouts, as well as lower SG&A expense year-over-year.

For our Progressive Leasing segment, gross merchandise volume decreased 14.8% to $540.9M in Q4'22 as compared to Q4 2021, primarily a result of the impact of the tighter decisioning executed in Q2 and weaker retail traffic. Revenue in the period declined 5.9%. However, the segment's Q4 gross margins improved year-over-year, returning to historical levels for the period.

Progressive Leasing's SG&A expense as a percentage of revenue declined year over year to 13.2% in Q4'22, from 13.4% in Q4'21, and SG&A expense decreased $6.4M year-over-year, also primarily a result of our cost actions.

Progressive Leasing's write-offs were $38.3 million or 6.5% of revenues in Q4, down from 6.8% in the previous year's period. Additionally, that 6.5% represents a decline from 7.2% in Q3 2022, and from our peak of 9.8% in Q2 2022.

Looking at our balance sheet, we ended the quarter with net debt of $468.1 million, a function of our $131.9 million in cash, and gross debt of $600 million, which is 1.83 times our trailing twelve months' Adjusted EBITDA. In 2022, we purchased 8.7M shares of our common stock at a weighted average price of $25.64 and have $337.3M dollars remaining under our previously authorized one billion dollar share repurchase program.

I'd now like to touch on a few key aspects of our 2023 outlook, which was provided in this morning's earnings release.

As Steve mentioned, we believe that economic and liquidity pressures felt by our customers will have an impact on our 2023 results, including GMV, which will face a tougher compare in the first half of the year due to the timing of our tightening in Q2 of last year. Additionally, we expect the year-over-year percentage decline of our first quarter GMV to be roughly in-line with our Q4 rate of decline.

We entered 2023 with a gross leased assets balance 5.3% lower year-over-year, which is the basis of future period revenue. We expect that this decline will serve as a headwind to revenue, particularly in the first half of the year.

Our base case does not assume further economic downturn or a material negative impact on the employment of our consumers, nor does it assume any benefit from tightening by providers above us in the credit stack. Some factors we did take into account include a decline in average ticket size, a lower average tax refund amount versus last year, and reduced government support programs.

Turning to our consolidated outlook for 2023, we expect revenues to be in the range of $2.34B to $2.44 billion, adjusted EBITDA to be in the range of $215 to $245 million, and non-GAAP EPS in the range of $2.11 to $2.54. This outlook assumes a difficult operating environment with continued soft demand for consumer durable goods, no material changes in the Company's decisioning posture, an effective tax rate for non-GAAP EPS of approximately 28%, and no impact from additional share repurchases.

As Steve mentioned, while the revenue picture for 2023 looks challenging, we anticipate that our lease portfolio performance and lower 90-day buyout rates in 2023 will drive our Progressive Leasing gross margins higher year-over-year, helping to offset much of the pressure to earnings from lower revenues.

In closing, I am also extremely proud of our company's ability to react to a macroeconomic backdrop in 2022 that was different from anything we have experienced in over 20 years in this business. Our team of dedicated employees showed a remarkable ability to quickly respond to external pressures, and I remain confident in our team's ability to continue that focused and adaptable approach.

I will now turn the call back over to the operator for the Q&A portion of the call. Operator?

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question will come from the line of Brad Thomas from KeyBanc.

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

I had a couple of questions, if I could. First one, kind of on the environment that you're in and one on how you're operating the business today. And so first, Brian, I think it was in your prepared remarks, you mentioned that the outlook does not factor in any benefit from tightening within the subprime part of the credit stack. And I'd just be curious what you're seeing out there and hearing out there and if you think you're starting to get any benefit from tightening in that part of the credit world.

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

Yes, Brad, appreciate your question. I'll let Steve weigh in on that as he's been closely following this with the sales team.

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

Yes, Brad. Good morning. Yes, I would just say this is -- it's kind of a confusing one for me because as we've talked about on several calls, this has been an expectation of mine for a while. But as you -- that should have happened already. And as you're looking at the cash reserves data and the savings rates, certainly, our customer was impacted more quickly than the prime customer, and we're waiting to see that prime customer show up in our application funnel.

You're starting to hear some of the prime providers using the word tightening on their calls, and you're certainly seeing their results higher delinquencies and higher provisions. Although I would say, we have not yet seen a material impact from those actions. Well, it's our expectation that it will lead to reduced credit supply above us on the stack, but we have not seen it to any material effect yet. And so while we think it will happen, it is not baked into our outlook because I've been terrible at predicting the timing of it thus far.

More specifically, we do operate our Vive business and there are a few instances where we are both the second look and the tertiary provider within a retail environment and Vive has tightened several times over the last 18 months and has seen a little bit of tightening for the prime provider above them. But more broadly, we have just not seen it yet, although we are watching like a hawk and looking for it.

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

That's helpful, Steve. And then I was wondering if you could just help us think a little bit more about how you think about the expense base of the business. Obviously, there have been many years where Progressive experienced significant growth. I think there's still a tremendous amount of growth opportunity ahead of you all, but nonetheless, a tougher operating environment here in the near term in terms of GMV.

How do you feel about the cost structure of the business, the level of spending? And maybe could you talk a little bit more about some of the specific savings opportunities that you may have here this year?

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

Yes, I'll start and Brian can chime in. We're very focused on the expense side. But as you said in your question, nothing has changed. Even though this has been a crazy couple of years managing and navigating through this environment, nothing has changed about our view on the size of the prize and the market that we're out there trying to capture. So while we're trying to be prudent on near-term results, we're also investing for the future.

As you will remember, we did a reduction in force last year, took out about 10% of our headcount. That was earlier than most did that. We definitely took some costs actions and we rightsized the expense base. As we started to plan for '23 and started to think about how our revenue picture was shaping up, we are very focused on the cost, and there's not really any hiring in the base plan. In fact, based on active leases and how GMV shapes out, there could be some headcount reductions due just through attrition in our ops area.

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But we are also operating in an environment of a tough recruiting and talent retention environment. There's wage inflation. And so we have to win with the team that we have in the field, and we think it's appropriate investment to invest back in those talented folks. As it relates to specific investments, we continue to invest in product and technology in order to improve our offering, both on e-com and in the customer experience. So we believe those are still right decisions because as you mentioned, it's been a tough revenue environment, but we don't think that this is the new normal that we do believe that that growth will come, and we look forward to springboarding off of a better foundation when it does.

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

Yes, Brad, I'll just add, as Steve said, it's a balancing act. And when we gave, obviously, the cost structure, a lot of thought in 2023. And I think the opportunity remains as well as the kind of near term -- the setup in the prepared remarks about the near-term headwinds on revenue, there's going to be a natural deleveraging, if you will, from an operating leverage standpoint with -- we're highly variable cost structure, we do have fixed costs, and that's going to be something that does weigh on margins in 2023 is our expectation. And so the numbers exist. We do control them to a large degree. I think it's in our judgment, been too reactive in this environment. I think it would be the right decision. We're going to be careful and thoughtful about the investments and the expected ROI from those investments as we evaluate that structure.

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

Really helpful. Thanks, Steve. Thanks Brian.

Operator

Our next question will come from the line of Anthony Chukumba from Loop Capital.

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

Thank you, good morning, thank you for taking my question. So just had a question on guidance, specifically first quarter guidance. So if I look at your first quarter guidance pretty simplistically, particularly from an earnings perspective, you're implying that earnings will be up pretty significantly year-over-year and that EBITDA will account for, call it, about 33%-ish of the full year EBITDA. And then I look back at last year, and EBITDA for the first quarter was about 25% of your full year EBITDA.

So it would seem to imply that you're expecting numbers performance to sort of get worse as the year goes on? Like I guess, what's leading you to think that? Or am I misinterpreting it? I'm just trying to sort of -- I'm just trying to square that all.

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

It's a good question, Anthony. And I'll start and Steve can weigh in as well. But I think there are some nuances as we enter 2023 that we're thinking about from a headwind perspective and given uncertainty in the environment we're throwing that all in the mixing bowl and I think that's what's reflected in the guidance. To start, we said in our prepared remarks on margin, we're entering this year with a gross lease asset balance is down roughly 5.5%, and so that's the driver of our future period revenue. So while it's impacting Q1 to some extent, we expect continued that amortizing the revenue pressures from that dynamic.

Steve also indicated some near-term GMV challenges to start the first half of the year and that's going to be in addition to the starting point on GLA. There's also an expectation within our model that we are -- while payment performance trends are much better than they were in the first half of 2022, we still haven't got back yet from, and I'm really referring to our accounts receivable provision. We're not yet back to what we saw pre-pandemic from a performance standpoint and so our expectation there is that there's still going to be some level of challenged customer payment performance to a degree within our model, and that's working its way through.

The last thing I'd say that would kind of front-weight the performance would be just the seasonality of that accounts receivable provision typically, and it feels like forever since we've had a normal cycle to talk about any kind of seasonality. But typically, in Q1, you will see the lowest bad debt expense, or AR provision in that period. So that's going to be helping the Q1 results, and we expect that to soften this as we look throughout the year. But those are kind of the three things I would point to, and I mentioned the deleveraging aspects as revenue builds pressure as well.

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

Got it. That's helpful. And then just one follow-up question. So you gave some very helpful stats in terms of your existing retail partners and the fact that the penetration lease penetration is growing and you execute these multiyear renewals, would just like to have any update in terms of the retail partner pipeline.

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

Yes. Thanks, Anthony. This is Steve. This will be my normal frustrating answer, but it's difficult to talk about the pipeline until we actually have a signed MSA, which we're obviously working on every day with various -- that's our goal, obviously, to convert that pipeline. We do expect to sign up some retailers in '23, whether they will be named and press release worthy remains to be seen. But we're positive about the pipeline. It's just that nothing has changed in the regard of what we're dealing with these large enterprise retailers, the timing of that conversion is difficult to predict.

But I'll say that nothing has changed. And in fact, when the economy is as tough in retail comps are hard to come by, we feel and are experiencing positive momentum and processes and conversations in other environments may have otherwise stalled. So certainly, it's a massive focus of ours to broaden our base so that when the retail environment is more positive that we have a bigger platform to grow from.

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

Got it. Yes. Your answer was frustrating, but consistent. Good luck with that.

Operator

Our next question comes from the line of Jason Haas from Bank of America.

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

So for the first one, I was curious if you could talk about how your retail partners are performing just generally. I'm curious how the holiday shaped up for them. And then as we started this year, how performance has been? I know that's been an issue that you called out weak customer traffic. It's been the case for a while. So I'm curious if there's been any signs of improvement? Or has it still been a pretty weak backdrop?

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

Yes, Jason, obviously we don't like to call any specific retailer and definitely not before they release their Q4 results. But -- and you have to do a little bit of read through. I know you're deep in the weeds, but the headline comps that they may report are going to be slightly different than the leasable categories that we participate in within their stores and also the price points, whether it be a super high-end mattress or a super high-end piece of jewelry would potentially perform differently than an opening price point item.

So, the holiday season it was generally weaker than we anticipated when we were going into it in kind of October. Not massively weaker because we were not expecting a strong one, but it was not -- it kind of seems to weaken as the quarter went on. We're not really commenting on what we're seeing since 12/31, other than to provide that outlook that we expect our GMV to be down in the same neighborhood as we were down in Q4 of '22.

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

Got it. Thanks. That's fair. And then as a follow-up, I think this question was maybe asked earlier, but I'm going to ask it a little bit differently. So for the cadence of the margin guidance through the year, I was getting to like about 11.5% for 1Q and then I think the remainder of the year is closer to 9%. Brian, based on your response to an earlier question, I think the biggest driver of that would be, it sounds like it's the AR reserve coming through. So is the effect of that, that we should see like maybe like outsized gross margins in 1Q and then it sort of normalizes in the remainder of the year?

And sort of along line to that, I guess my question more broadly is just for this year for 2023, if I compare your P&L for what you expect

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for 2023 versus what we saw like pre-pandemic in 2018 or 2019, I think we're still -- I think margins are still below where you want them to be that like 11% to 13% target. So I'm curious what's the driver of that? Is it the AR provision or write-offs coming in higher? Is it just like wage inflation over the years? So if you could kind of help compare those two, that would be helpful, too.

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

Yes. Let me take a stab at that in pieces. I think your math is roughly correct in terms of the rest of the year margins. And, linking it back in my earlier response, in order of magnitude, I'd say, the deleveraging aspect of this is real and probably is slightly above the AR component that I referenced. And when run internal model, the sensitivity on that is pretty meaningful in terms of -- if you're growing 5%, 10%, your margin profile can improve pretty meaningfully and quickly get to certainly the low end of that 11% to 13%. So I think the focus on growth and investments in growth are critical to getting that margin where we have typically seen it. But obviously, we're going to hold ourselves accountable on those investments and make sure that they are the bleeding through the margins over time.

I think historically, just to keep in mind, obviously, '18 and '19 as PROG reported out were to spend on public company at the time. So a lot of the costs of being public are there but when you're talking about something north of 11% EBITDA margin, I think as Steve and I had talked about it internally, that's certainly where we want to be. And I think there is -- if you think about the variable cost of the business, the contribution margin that it generates, it's attainable. And so we've got some execution that we need to see happen to get us to where we want to be there.

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

I would just add and Brian can keep me honest here, but your point about theAR provisions, debt expense, I mean. While we're happy with where the portfolio is and proud of the actions we took last year to get the write-offs where they are and the portfolio where it is, we do expect BDE when 23 has also done to be higher than better than '22 and comfortable but still higher than the pre pandemic levels by some measure.

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

Got it. That's all helpful color. Thank you.

Operator

Our next question comes from the line of Bobby Griffin from Raymond James.

Alessandra Lynn Jimenez ***Raymond James & Associates, Inc., Research Division - Senior Research Associate***

Good morning. This is Alessandra Jimenez on for Bobby Griffin. First, I just wanted to touch on kind of loosening terms. So what would you need to see in the economy or payment performance to start to loosen terms again and go after more GMV growth?

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

Yes. So from a decisioning standpoint, we're in the kind of the same ballpark from a decisioning posture that we've been in since the summertime when we talked about our tightening actions. Our base case does not assume a recession in 2023, but it also doesn't assume really any tailwinds or any improvement. We're watching all the BLS data and all the leading economic indicator data. As we mentioned on the prepared remarks, the liquidity stress is high for our consumer, credit utilization is up. So, we meet every two weeks on our risk committee, and we review the portfolio by vintage pool and how it's playing out. And we also review an inventory of levers that we have at our disposal, which some are to tighten in pockets and some are to look for opportunities to increase approval rates.

We don't want to knowingly leave profitable GMV on the table for us or our retail partners. But we also feel like in this uncertain environment that we're operating in, a little bit of a defensive posture is appropriate. I certainly hope it's not my baseline expectation but I hope that as we move through this year, we can look for opportunities to increase approval rates, and we have those initiatives at the ready, but we're just being prudent before we deploy them.

Alessandra Lynn Jimenez ***Raymond James & Associates, Inc., Research Division - Senior Research Associate***

That's very helpful. And then maybe just a follow-up on that. What have you seen in terms of application volumes? Are you continuing to see sequential pressure? Has that kind of stabilized modestly?

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

Yes. We have to look at it by channel, right? So in-store volumes are kind of flat to slightly down, e-comm volumes are up a little. But when you kind of go through the funnel, there's a pretty material difference in funding GMV from an in-store versusan e-comm app, and that makes sense. There's higher purchase intent when someone is in the store talking to our sales associates. So approvals-in are higher in-store. Conversion rate is higher in-store. So when you have app increases online, it has -- while the big numbers kicks in, it does have a smaller flow-through per app, at least to GMV.

So that's something we're watching from the app side that we're watching, but we're also more specifically launching the profile of the app to look for evidence of that opening at the top of the funnel from the credit providers above us tightening. But that's what we're observing so far.

Alessandra Lynn Jimenez ***Raymond James & Associates, Inc., Research Division - Senior Research Associate***

Thank you so much, and best of luck in 2023.

Operator

Our next question is comes from the line of Hal Goetsch from Loop Capital.

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

To ask you about the components of GMV for 2023. And like your thoughts on how much of it you might think is coming from, say, a back book, merchants you had on the books in 2021 that are like basically same-store sales all through 2022 and 2023 now, and then merchants you added in 2022. And then your assumption for GMV that might come from merchants you add this year that are those in your forecast? Give us your thoughts on those kind of three buckets of like where GMV is being originated from?

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

Yes. So I'll start with the last one. We always have a number in our GMV plan for pipeline. We want to make sure we keep that pressure on the business team. So pipeline is in there but the named accounts are the really exciting ones. Even if we have an announcement this year, probably it would not be a material impact to '23 GMV. So there's a smaller number in our view or our outlook from a pipeline standpoint. And then the rest is kind of just baseline existing retailers and not really with a specificity of calling out the 2019 vintage or the '21 vintage.

We do have the ability and the initiatives to become more productive. And so that will ultimately play out in what you said, which is kind of like a same-store sales metric but we have the ability. We're focusing on the deeper integrations as we mentioned in our prepared remarks. And so e-com cart integrations, which we've talked about over the last couple of years, we still have some opportunities with top 10 partners in that area. More waterfalls, more prominent displays on landing pages and PDPs on the e-com side, in-store POP, credit waterfalls,things of that nature in order to increase and grow GMV within the same retail environment and continue to grow that balance of sale even in a potentially down comp environment for that retailer.

One thing that we mentioned, and I just want to reiterate here, is we're obviously still comping against the higher approval rates from 2022 in the first half. So in the first half of '23. So that will be more difficult to overcome even with those productivity initiatives and the timing of those productivity initiatives are difficult to predict even throughout the year because we have to collaborate and partner well with our retail partners, tech teams, or merchant teams. Whatever the project might be we're working hard on using this opportunity to become a more meaningful partner with all of our retailers, and we have some well-developed road maps at the partner level to achieve that.

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

Okay. I can ask a follow-up on your risk model. You're now trending towards the lower end of your lease write-off range. The job market for maybe the lease-to-own customers seems to be very, very strong at this point in time. And like your color on how the job market is backing into your decisioning? And what we heard from other lenders in the less than prime space, several companies have said, "Hey,

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we're probably leaving some loan volume on the table or doing less than we could a bunded caution." I just wanted to get your thoughts on where you stand to a statement like that because all these companies are focused on the job market, which is pretty good, but they're all saying they'd probably leaving some volume on the table what are your thoughts on that?

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

Listen, I mean, I think we were all -- for a couple of years, we were all are armchair virologists, trying to figure out the pandemic, and now we're all armchair economists trying to figure out what's going to happen on the macro side. And I am no exception to that because I always frustrate my team talking about all these macro things I hear on CNBC when I'm working out in the morning.

So listen, the one thing that could be a tailwind for us that would be a welcome tailwind is we might actually see some increase in the employment rate but not in our customer base, right? And so you kind of alluded to that. That jobs number for January was -- blew the doors off. I don't know if that's sustainable or not. I don't want to get into a big long economics commentary that I'm not qualified to give. But I would say that there are some elements of the macro that could actually break our way. I'm not used to things breaking our way over the last couple of years, so I'm not counting on them.

But back to your original question, I mean, it's possible and probably more likely than not that we are leaving some volume on the table out of an abundance of caution, and I think that's the appropriate position for us to be in until we get some more clarity.

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

Thank you.

Operator

Our next question comes from the line of Vincent Caintic from Stephens.

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

Most of my questions have been asked. I wanted to touch on cash generation, your expectations for 2023. And I know in the 2023 guidance, there was no share repurchases, but you were active in 2022. So I just wanted to get your thoughts on how you're thinking about capital return for 2023.

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

Yes. I mean from a cash standpoint, we will generate cash in 2023. That's one of the really nice elements of our business model with a good cash conversion cycle and the short duration portfolio. So obviously, the timing of the GMV production will impact the actual cash levels. And Brian was right when he said we haven't had a normal year in many, many years. But in a normal year, we would generate more than 100% of our cash in the first half of the calendar year. And then, depending on GMV production in the back half, we might actually be a cash user. But over the course of the year, we will generate positive cash flow.

As it relates to share repurchases or shareholder return, obviously, our history would show that we have optimism about our future prospects. I think the shares are a good value here. We'll always look at it through the lens of prudent capital allocation, and I want to keep a strong balance sheet, keeping kind of a view over the next two years-ish on what the leverage ratio will look like and we'll always prioritize investment in the business first. But then by our definition of excess capital, we'll look to return to shareholders. And our history would show we generally favor the share repurchases. And I don't remember the exact number, but I think it's in the neighborhood of $337 million is remaining under our original board authorized share repurchase program.

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

Okay. Perfect. That's very helpful. And then last question, just a quick follow-up on the merchant questions from earlier. So understanding the comments on the pipeline. But when you talk about with your existing merchant partners and there was some discussion about engagement there, I was wondering if you could maybe talk about that in more detail. Are you seeing more, say, co-marketing campaigns or anything like that? Or is the engagement increasing there?

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

Yes, thanks, Vince. Yes, we definitely are. I mean, I'm pleased with the level of engagement. I don't think we've had better collaboration and partnering with our counterparts at our merchant partners than we have now. And that makes sense because every retailer is out there trying to scratch and claw for comps. So the idea of someone always having a negative view on point of purchase material in stores, but then deciding, okay, let's try that out and give it a test. That's a positive development.

The PROG Partner Week, which has been really successful, and kudos on the marketing team for coming up with that, we've got more and more partners wanting to participate in our PROG Partner Week, which really markets to previous customers on a co-branded, not co-branded, -- well Progressive is co-brand as well but the two of our merchants would send something out with Progressive on there as well. For example, like Best Buy and Kay Jewelers or something like that. So that's increasing in velocity and frequency, and we're seeing some good returns there.

And then just generally, we have a pretty good track record and data backing up like -- I've talked about the tools in our tool belt for years now and conversations and potential resource allocation, which is the most important part of that statement are positive. And like if there's tools that are less unused in that tool belt across a specific merchant partner, those things. Now there's always limitations and everybody had good intentions, and they might not have the resource to be able to execute on that before holiday this year or something like that.

But we're focused on taking as much of the burden off the retailer as we can and putting that work on our side of the ledger to the extent we can. We can't do it 100%, but to the extent we can make it easier, have easier integrations, and easier deployment of those tools that benefits us and the retailer, and makes us a continued preferred partner. So we're encouraged by those things, and we hope to have actual evidence in execution of a number of those things in 2023.

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

Perfect. Thanks very much.

Operator

I'm not showing any further questions in the queue. I'll turn the call back over to Steve for any closing remarks.

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

Thank you, Operator. I appreciate you all joining us today as we wrapped up a very challenging 2022. 2023 also has its challenges, but we're optimistic about what we can accomplish and what the future -- the multi-year --the near-term, intermediate-term future holds for us. I really just want to reiterate my appreciation and thanks to the team for executing well and for doing the work that's going to get us to where we need to be. So we look forward to updating you all here shortly in 60-or-so days at the end of April about our Q1 results.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect. Everyone, have a great day.

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