America's Car-Mart (NASDAQ: CRMT)
Management remarks as recorded on FY 24 Q1
September 4, 2024

Vickie Judy, America's Car-Mart CFO

Good morning, and welcome to America's Car-Mart's first quarter fiscal year 2025 earnings call for the period ending July 31, 2024. Joining me today is Doug Campbell, our company's President & CEO.

We've issued our earnings release earlier this morning and it is available on our website, along with a slide detailing our cash-on-cash returns. We will post the transcript of our prepared remarks following this call, and the Q&A session will be available through the webcast after the call.

During today's call, certain statements we make may be considered forward-looking and inherently involve risks and uncertainties that could cause actual results to differ materially from management's present view. These statements are made pursuant to the safe harbor provision of the Private Securities Litigation Reform Act of 1995. The Company cannot guarantee the accuracy of any forecast or estimate, nor does it undertake any obligation to update such forward-looking statements. For more information, including important cautionary notes, please see Part 1 of the Company's Annual Report on Form 10-K for the fiscal year ended April 30, 2024, and our current and quarterly reports furnished to or filed with the Securities Exchange Commission on Forms 8-K and 10-Q.

Doug will start us off with his thoughts on the business and strategies for this fiscal year.

Doug Campbell, President & CEO

Thank you, Vickie. And thank you everyone for your interest in America's Car-Mart, and for joining us to hear more about our first quarter results. As I mentioned in the earnings release, I'm pleased about the improvement in sales volume versus the prior year when viewed sequentially. If you recall, we were down almost 20% in the third quarter. We then finished down 13.6 % in the fourth quarter and have closed the gap now to just under 10%. We're pleased that website traffic increased both year over year and sequentially, indicating strong consumer demand. However, application volumes were slightly softer, contributing to the decline in sales volumes. We believe that part of this decline is the need for more affordable vehicles. We've been working hard to bring down the average retail price during the quarter. When viewed sequentially, we had a reduction of approximately $100 in the first quarter in average retail price when you exclude ancillary products. Vehicle procurement prices are a good leading indicator for our average retail prices, and with the progress we've made during the quarter, we expect these benefits to both improve and continue.

Gross margin continues to be a positive story, up 30 basis points for the quarter. We remain very focused on gross margin improvement through pricing discipline, reduced transportation costs and lower vehicle repair costs.

The biggest challenge for our industry, and for us, is ensuring that we match inventory levels and pricing to the demand and the type of consumer we're seeing in the marketplace. We've taken several actions in the value chain to lower vehicle acquisition costs, which means we can pass those savings on to our consumers. Our partnership with Cox Automotive is a key component in our plan to address affordability for consumers and improve gross profit margins for the company. Recall that this partnership is centrally managed, removing the day-to-day burden from our location managers to oversee the complete process for the disposal of our assets.

We've been optimizing agreements with vehicle repair shops and consolidating suppliers to lower acquisition and transportation costs. We've set new expectations for vehicle quality, especially with preferred vendors, and continue to consolidate vehicle vendors. The vendor consolidation process is also improving title flow, which speeds up the time in getting inventory to the sales lot and then displayed online. For example, in fiscal year 2023, we purchased an average of 10 vehicles from close to 400 vendors monthly. In fiscal year 2024, we dropped that to roughly 270 vendors, and this year, we plan to bring that down to under 200 vendors. While we still need local relationships in many markets that we operate, the partnership with Cox Automotive is giving us additional options. Like any transition, the onboarding process of a new partner for our business operations is not without its challenges; however, we believe those are mainly behind us now as it relates to procurement and remarketing vehicles.

I'll switch now to the customer-facing aspects of our business. The LOS is fully in place at 147 of our 156 dealerships. The remaining nine dealerships, which were acquired, are still in their earn-out period or have yet to be integrated. As of July 31, almost 40% of our total portfolio dollars originated within the LOS. The speed at accomplishing sales and financing process is at least one hour faster for each customer. Because more of these sales are starting online, it allows for a better overall customer experience, and we're pleased to see this kind of adoption. And it gives us additional data on consumer preferences and the prequalification trends we're seeing.

The benefits from LOS that we discussed last quarter which include curtailing originating terms, generating better deal structures, and ultimately improving loss rates – continue to build momentum. Deals originated through the Loan Origination System versus our legacy system have a lower frequency and severity of loss, thus producing a lower overall cumulative net loss rate than loans originated during the same period. This improvement is also very much in contrast with our back book of originations, which are now approximately 33% of our portfolio when looking at overall dollars from Fiscal year 21 through Fiscal Year 2023. I'll let Vickie get into more detail here in a moment on that.

We're moving quickly to reshape our future without changing our core mission – keep customers on the road. Our initiatives are strengthening Car-Mart's competitive position, enhancing our ability to innovate, and increasing operational efficiency. I reported last quarter on the implementation of additional multi-year tech investments in our business, specifically an enterprise resource planning system, or ERP. This was a significant multi-year investment and it's weighing on our operating expense line. The benefits of this ERP conversion are designed to improve efficiency and operational flexibility within finance, accounting, and customer management functions, and provide capacity for growth. We went live on the system on May 1st and are confident that we can help provide leverage in SG&A. We also completed several important enhancements to our CRM during the quarter which are designed to assist us in credit application conversion. A better customer experience will drive higher conversions to sales.

We're very pleased with the recent addition of the two dealerships at Texas Auto Center, which delivered strong results as expected in the quarter, including a record month in July. We have ambitious plans to grow America's Car-Mart and become a more dominant company in our segment. This is evident in the turnaround we're beginning to see. Our teams will be a key component of our success.

I'll now turn the discussion over to Vickie for more details on our financials. Vickie …

Vickie Judy:

Thanks Doug and good morning, everyone. In my commentary, the comparison that I will cover will be the first quarter of fiscal 2025 versus the first quarter of fiscal 2024, unless otherwise noted.

Total revenues decreased $19.0 million, or 5.2%, largely due to a decline in retail units sold. Interest income increased by 7.2%, primarily due to the increase in the consumer contract interest rate to 18.25%, which was increased from 18% in December of 2023. The weighted average interest rate was 17.4% at July 31, 2024, compared to 17.0% at July 31, 2023.

As Doug pointed out earlier, our priority in both sourcing and sales is on vehicle affordability, as our customers are persistently squeezed by several economic factors affecting their paychecks. Average units sold per dealership per month were down from 34.2 to 30.9, or 9.6%. The average retail sales price was up 2.4%, primarily attributable to increases in ancillary products. We continue to balance the appropriate underwriting risk with sales volumes and have limited originations at a select number of dealerships to focus on collections and originating only the highest credit scoring applicants. This has contributed to lower productivity on average.

Earlier, Doug explained that the back book of originations from fiscal 21 through fiscal 23 accounts for 33% of the portfolio, and that 40% of the portfolio originated through our new underwriting system. We're pleased with the benefits we're seeing on down payments and deal structures. Down payments for the quarter were up 20 basis points to 5.2%. While this is not an enormous increase overall, the distribution of the down payment by customer score is improved and is expected to be significant in terms of customer success. This also builds on last quarter's sequential increase of 40 basis points on down payments.

Our average originating term was 44.3 months, down from the prior year's quarter average of 44.7 months. Like the down payment, we continue to fine-tune and optimize the distribution of the term by customer score. At the end of the quarter, the weighted average total contract term for the portfolio is 48.1 months. The weighted average age is 12.0 months, or up 16%. This should have positive impacts on the portfolio losses going forward and has contributed positively to the increased collections per active customer.

Our management and dealer teams have worked hard to improve total collections, which increased 4.3% over last year. The monthly average total collected per active customer rose to $562 from $535. More customers are paying via digital channels, but it is valuable to leverage our hybrid approach because the local face-to-face relationship is a difference maker when they need contract modifications or assistance.

Net charge-offs as a percentage of average finance receivables for the quarter were 6.4% compared to 5.8%. We experienced an increase in both the frequency and severity of losses, with severity accounting for approximately 65% of the increase. The majority of this increase continues to be from the back book of the fiscal year 22 and 23 originations. These originations now have a weighted average age of approximately 22 months at the end of July and are expected to have less of an impact on net charge-offs as we move forward. The net charge-off percentage is trending back to pre-pandemic averages and is closer to the low end of our historical range of 5.9% to 8.7%.

Our priority is customer success and to work with them to resolve payment delinquencies before repossessing the vehicle. We're pleased that our delinquencies – or accounts over 30 days past due -- dropped 90 basis points to 3.5% at quarter end, and our recency was over 82% for the quarter.

The results we're seeing from our LOS originations were the primary driver in a 30-basis point improvement in our allowance for credit losses as a percentage of finance receivables, net of deferred revenue and accident protection plan claims. This puts the allowance at 25.00% at quarter end, which resulted in a $4.3 million reduction in the provision for credit losses.

Inventory levels at quarter end were up $7.1 million compared to fiscal year end, primarily due to the addition of our most recent acquisition which added approximately $5.1 million to the inventory balance. Despite this addition, we reduced inventory by $2.6 million compared to the prior year quarter end.

We've been sharing our cash-on-cash returns profile during this past fiscal year and are pleased that our originated contracts in the first quarter are expected to produce cash-on-cash returns of 72.4%. The supplemental material to the earnings release reflects our history of earning strong cash-on-cash returns in various market and macro-economic conditions. We're very focused on the quality of originations and deal structures to maximize these returns and profitability.

Moving to SG&A …SG&A expense was $46.7 million. This was a slight increase compared to last year's first quarter. As mentioned in the release, we had over $2 million in savings in payroll and related costs due to prior cost cutting measures. This was offset by increases in the licensing and expenses related to our technology implementations, along with the increased SG&A related to the acquisitions, which created some headwind in leveraging the SG&A on a per customer basis. As we move forward and gain efficiency from the new technology and build the customer base associated with the acquisitions, we expect to leverage the SG&A on a per customer account basis over the long term. We continue to focus on driving cost efficiencies and continue to execute on cost control measures.

Interest expense increased by $4.0 million, or 28.3%, due to a rise in rates and secondarily an increase in debt. Our revolving credit facility and warehouse notes payable are floating rate debt, and we would benefit from lower rates if the prevailing thoughts on interest rate cuts come to fruition.

As of July 31, we have $4.7 million in unrestricted cash and approximately $33.0 million in additional availability under our revolving credit facilities calculated on our borrowing base of receivables and inventory. Access to capital, with our revolving credit facility and a successful securitization program, give us flexibility and a distinct advantage over many of our smaller competitors. Now, let me turn things back to Doug.

Doug:

Thanks Vickie. We know that the economy is challenging for consumers, and we're undertaking many operational initiatives to improve certain aspects of our business. I'm proud of our associate value proposition and the dedication of our teams. Before we start the open Q&A, I'd like to reiterate our focus for the fiscal year:

1. First, we want to continue to push for operational excellence on sales and collections as we leverage the technology recently installed and updated. This includes constantly looking at the return on invested capital at our stores and ensuring that we are focused on getting the best returns possible for our shareholders.
2. To improve the affordability for our consumers by reducing the average retail price during the fiscal year. There are several components to this plan, but we're well under way and will continue to see benefits here.
3. The continued optimization of our loan origination system. We're seeing its benefits, and I believe we're just scratching the surface. Our credit and underwriting teams are working to fully exploit the benefits of this system.
4. To capitalize on our partnership with Cox Automotive. I believe this to be a long-term partnership, and we are just getting out of the gates. I'm excited about the benefits for our shareholders and collective companies here.
5. Is to implement our strategic plan and focus on acquisitions. We're actively in the market looking at opportunities and believe this is still the best return for our shareholders.

I'd be remiss if I didn't mention just how important people are to our success, both existing talent and new talent that will round out our leadership team. Now operator, please provide instructions to ask questions.

Note: For the Q&A session, please refer to the webcast recording.