America's Car-Mart (NASDAQ:CRMT)
Management remarks as recorded for FY 25 Q2
December 5, 2024

Vickie Judy, America's Car-Mart CFO

Good morning, I'm Vickie Judy, the Company's Chief Financial Officer. Welcome to America's Car-Mart's second quarter fiscal year 2025 earnings call for the period ending October 31, 2024. Joining me on the call today is Doug Campbell, our company's President and CEO.

We issued our earnings release earlier this morning and it is available on our website, along with supplemental slides detailing our cash-on-cash returns and our new Loan Origination System ("LOS") performance improvements. We will post the transcript of our prepared remarks following this call, and the Q&A session will be available through the webcast.

During today's call, certain statements we make may be considered forward-looking and inherently involve risk 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.

I'll let Doug start with color on the quarter and perspectives on Car-Mart's business strategies. Doug, I'll turn it to you now.

Doug Campbell, America's Car-Mart President & CEO

Thank you, Vickie. We had significant activity during this quarter that I want to comment on, which were designed to shape our outcomes in the future. In September, we amended our revolving credit facility. The purpose was to provide additional cushion around our financial covenants, to help navigate uncertainty around the macroeconomic environment and the back half of the year. We raised approximately $74 million of net proceeds through the issuance of new shares. It's important for me to explain the rationale for this decision. Our management

team and board of directors gave very thoughtful consideration and review ahead of this decision given its dilutive effect on current shareholders. Our performance over the past few quarters was below our expectations, which was an important factor in our decision to bolster our balance sheet. As we've talked about in the past, we've been challenged by marketplace factors. On the sales side, we have tightened underwriting standards given the industry-wide auto loan loss pressure, evident by the performance of our own back book. Our consumer is and has been more susceptible to challenges in today's inflationary environment. We needed breathing room in our forecast to account for these factors. We did consider options that would increase additional leverage in various forms. But, ultimately, we felt that equity was more prudent. This decision pained us to execute; however, we felt that it was the best decision for all shareholders to maintain flexibility during marketplace challenges and a higher interest rate environment.

With the equity raise completed, the Company is currently in discussions to extend the revolving credit facility, which matures in September 2025, and we're working through potential initiatives to expand the Company's funding program while also making it more robust. These initiatives include options to add warehouse capacity, a redesigned floorplan facility, and a bespoke line of credit for receivables originated by our acquired dealers. The objectives of these facilities are to increase overall availability, optionality on when we enter the ABS market, and to build a level of redundancy and conservatism in our funding structure. We appreciate the support of our ABL – Asset-Based Lending -- partners, and they will continue to be a critical part of our capital structure. They have been supportive for many years, and we appreciate their consideration in navigating near-term challenges to date. We will share more with you on our progress on these initiatives in the coming quarters.

We completed our fifth ABS transaction in October. This transaction was $300 million in size and well over-subscribed, generating over $1.5 billion in demand. We believe the improved demand was for loans underwritten by LOS, which represented approximately 70% of the receivables in this transaction. Ultimately, this enabled us to have the tightest spreads we've had to date, which when combined with lower benchmark rates, resulted in an overall coupon of 7.44%, a nearly 2-point improvement over our January transaction. This platform is important for

us given its material improvement in the advance rate relative to the ABL and the access to additional capital for a growing portfolio.

Also, in October we welcomed our new chief operating officer, Jamie Fischer, to our leadership team. Last quarter I mentioned how important existing and new talent will be in rounding out our leadership team. Her skillsets will complement and accelerate our growth, and she's already proven to be a great fit within the organization.

Before turning it over to Vickie, I want to comment on our continued improvements in underwriting.

Back in June, I spoke about the LOS results relative to the loans generated on our legacy system during the LOS rollout. At the time, we noted that it was still early, but we were optimistic that the results that we were seeing showed a 20% improvement in cumulative net losses through May. An update through October is now showing this at a 21% improvement in cumulative net losses. On the surface, it's very difficult to see where such nominal changes to downpayments, originating term lengths, payment-to-income ratios, and overall amounts financed could represent such an improvement to cumulative net losses, but our focus has been on the cohorts of customers with the most risk within our customer rankings. We rank our consumers 1-6, with 6 having the very best credit, and 1 rank customers holding the most risk. Approximately 40% of our sales come from ranks 1-4 consumers; and that has been where most of our focus has been for us on improving loan structures and allowing more flexibility to 5 and 6 ranked customers. On these lower cohorts, we systematically now can hold more control over these structures when compared to our legacy system. This has resulted in a 15% improvement in down payments, allowing us to carry smaller loan sizes of $400-$800 less depending on customer rank, and curtail originating terms by 3 months on average, in addition to lower payment to income ratios. Looking at the bottom quartile of stores, those results are even more pronounced. The LOS receivables within the portfolio at quarter end represent almost 50% of the portfolio dollars. In terms of the number of contracts, it's about 38%. It's why we're starting to see an improvement sequentially in the severity of loss, but the volume of contracts originated in the legacy system are still driving the frequency of loss. We were able to take another reduction in our loan loss reserve percentage based on the LOS improved

performance and the increasing size of the portfolio impacted by it. We expect a crossover point at the end of the fiscal year where the LOS will start to be a larger driver on both frequency and severity.

With that overview, let's turn to the second quarter financial results. Vickie…

Vickie Judy:

Thanks Doug.

Before I get started on the details, I want to cover an accounting adjustment that we made in the quarter related to our service contracts. Our longer-term service contracts that we rolled out in 2021 have now been through a full cycle, and based on a detailed performance analysis, we found that customers reach the mileage portion of their service contract earlier than the contract term. Because of this, we reduced our revenue recognition period to better match the time of usage by the consumer. This resulted in an acceleration of deferred service contract revenue of $13.2 million during this quarter and will result in a 25% quicker recognition of revenue on both existing contracts and any new contracts originated going forward. This started in the second quarter and is expected to improve gross margin of approximately 1% on a go-forward basis, absent any other variances to gross margin.

In my remaining commentary, the comparisons that I will cover will be the second quarter of fiscal 2025 versus the second quarter of fiscal 2024, unless otherwise noted.

Total revenues decreased $12.5 million, or 3.5%, largely due to a 9.1% decline in retail units sold. This was partially offset by a 3.6% increase in interest income and the $13.2 million service contract benefit.

Sales volumes were impacted by a number of factors, including the affordability of vehicles for our consumers, although we did see sequential improvement. This past quarter was also impacted by some weather events and the closing of two dealerships early in the quarter accounting for about 15% of the sales miss to the prior year. 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 servicing to maximize returns. This has also contributed to lower productivity on average, but improved asset quality. I'll cover more on the portfolio statistics in a moment.

The average vehicle retail sales price, excluding ancillary products, was $17,251, a reduction of $212 or 1.2% sequentially. We provided a breakout of the total average retail sales price per unit versus the ancillary sales in our earnings release this morning. This should make it easier to isolate the vehicle price movement going forward.

Gross margin as a percentage of sales was 39.4%, or 36.5% excluding the impact of the $13.2 million service contract revenue recognition benefit. The initiatives around procurement and our partnership with Cox continue to drive improvements to vehicle affordability and the resulting gross margin percentage. We're pleased with the continuing progress in improving the gross margin percentage and will continue to be focused on driving to the 37%-38% that we've mentioned in prior quarters.

Net charge-offs as a percentage of average finance receivables for the quarter were 6.6% compared to 7.2%. Our fiscal year 2023 and earlier originations are still the primary cause of underperformance, but represent less than 30% of the portfolio dollars currently. However, as Doug mentioned, the LOS originations represent approximately 50% of the portfolio dollars and are continuing to drive the improvements in the allowance for credit losses. The allowance as a percentage of finance receivables, net of deferred revenue and accident protection plan claims was 24.72% at quarter end, down from 25.0% at July 31, 2024.

Doug covered the work we've done to achieve improvements in underwriting through our LOS system. Down payments for the quarter were up 30 basis points to 5.2%. The focus of our sales teams on larger down payments, especially with higher-risk customers, is benefiting the performance of fiscal 2025 pools, and will benefit our customers as well.

Our average originating term was 44.2 months, close to flat compared to the prior year and a slight reduction sequentially. This term flattening is improving collections and benefiting loss improvement. We continue to optimize the distribution of the term by customer score –

shortening term for our highest credit risk customers and allowing additional term for our best credit scoring customers. At the end of the quarter, the weighted average total contract term for the portfolio is 48.2 months, with 35.9 months remaining. The weighted average age is 12.3 months.

We continue to make progress on boosting overall collections, which are up 3.3% over last year. This is also a sequential improvement from the first quarter. The monthly average total collected per active customer was $560 from $533.

Delinquencies – or accounts over 30 days past due – improved 10 basis points to 3.5% at quarter end, and was flat with the first quarter of fiscal 2025. Recency was 81.8% for the quarter.

Moving to SG&A …SG&A expense was up $2.5 million, an increase of 5.7%. This was primarily driven by a $2.1 million increase related to the two acquisitions completed since last year. As mentioned, we measure SG&A efficiency on a per account basis. In the short term, these acquisitions create headwinds in our ability to leverage SG&A on a per customer basis while they build out a portfolio of customers. These acquisitions are expected to add 5,000 or more accounts over the next 18-24 months. Sequentially, SG&A increased approximately $697,000, primarily due to stock compensation increases.

Interest expense increased by approximately $1.5 million, or 8.8%, due to the rise in rates and secondarily an increase in debt. Sequentially, we had a decrease of approximately $270,000 in interest expense as we began to see the improvements in rates and results from the equity raise in reducing the amount of debt, net of cash.

As of October 31st, we had $8 million in unrestricted cash and approximately $97 million in additional availability under our revolving credit facilities calculated on our borrowing base of receivables and inventory.

Now, I'll turn things back to Doug.

Doug:

Thanks Vickie. We're pleased with the progress we've made on underwriting powered by our technology investments. However, last quarter I discussed the importance of unlocking more capability of the LOS system by utilizing risk-based pricing for certain customers. Our goal was to have a pilot kicked off before the calendar year ended, and we were successful in that effort. We're currently in a few markets testing pricing structures, and the results to date are good. In this pilot, we enabled risk-based pricing and the implementation of a new scorecard that adds more granularity to the applicant pools and gives us better predictability of loss. This gives us another lever to pull to help both retain and grow the business. We believe this makes us more competitive in the upper end of our credit spectrum, and will also allow us to price in the appropriate returns for lower-ranked customers in our system. Our credit team has done a nice job of ensuring this was delivered timely and without issue. We should have a more comprehensive update by the fiscal year end as we get more data and results flowing through the system.

Additionally, we are pleased to see gross margin continue to improve and vehicle price come down sequentially. In fact, excluding the service contract benefit, this was the highest gross margin percentage on a quarterly basis in the past 10 quarters. We expect to see continued benefits in the back half of the fiscal year on affordability and it's especially important to get this right as the tax season approaches.

Our teams are critical to the Company's success; their hard work and focus on the execution of our initiatives continue to drive these improvements. We appreciate the contributions of all our associates in serving our customers.

Overall, we're focused on all our stakeholders: customers, associates, and shareholders. We appreciate their belief in the platform, and we believe Car-Mart is well positioned for future growth and profitability.

We'll move on to the Q&A session now. Operator, please provide instructions to ask questions.

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