FlexShopper, LLC
Q1 2019 earnings call
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Operator: Greetings. Welcome to the FlexShopper First Quarter 2019 Earnings Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. If anyone should required operator assistance during the conference, please press star zero on your telephone keypad. Please note this conference is being recorded. I will now turn the conference over to your host Jeremy Hellman, of The Equity Group. Mr. Hellman, you may begin.

Jeremy Hellman: Thank you, operator. I would like to remind everyone that we have posted an updated investor presentation within IR section of the company website, www.flexshopper.com. This presentation includes forward-looking statements that are made pursuant to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995.

Forward-looking statements reflect our current views with respect to future events and involve inherent risks and uncertainties, which could cause actual results to differ materially from our historical experience and present expectations or projections as a result of various factors including those risks and uncertainties described in the risk factors and the management's discussion and analysis of financial condition and results of operations sections in the company's most recently filed annual report on Form 10-K and subsequently filed quarterly reports on Form 10-Q. One can find many but not all of these statements by looking for terms such as belief, expect, hope, project, may, will, should, would, could, seek, intend, plan, estimate, anticipate, and similar terms. All statements other than statements of historical facts included during this conference call including statements regarding our strategies, prospects, financial condition, operations, costs, plans, and objectives are forward-looking statements. We urge you to consider those risks and uncertainties in evaluating our forward-looking statements.

We caution listeners not to place undue reliance upon any such forward-looking statements, which represent our estimates and assumptions only as of the date hereof. Except as required by law, we undertake no obligation to update any forward-looking statement, whether written or oral, that may be made from time-to-time whether as a result of new information, future developments, or otherwise. We anticipate that subsequent events and developments will cause our views to change. With that, I would like to turn the call over to FlexShopper's CEO, Brad Bernstein. Go ahead, Brad.

Brad Bernstein: Thank you, Jeremy, and welcome everyone to our 2019 first quarter earnings call. I'll start by providing several business highlights from the first quarter of 2019, then I'll hand the call off to our CFO, Russ Heiser, who will discuss our financial results and balance sheet in more detail, and then I'll return for some last comments before we open the line up to your questions.

First and most importantly, I'm pleased to report our first quarter of net income at $504,000 before preferred dividends and solid adjusted EBITDA of $2.3 million. Over the last few earnings calls, we've been alluding to an inflection point in our business of reaching a critical mass of annual lease originations. When you combine steady lease portfolio returns with continued lease origination growth, continued repeat business, and other channels kicking in such as our B2B retail channel, the profitability and merits of our model are realized. Let's go through some of the other strong data points for the quarter. We originated 36% more leases in the first quarter of 2019 than for the same quarter last year. Lease originations through third-party retail stores where we saved the sale for retailer with lease purchase financing grew 214% compared to the same period last year.

Overall, our B2B retail channel contributed 26% of all lease originations compared to 11% in the first quarter of 2018. We expect our B2B channel to grow even more as we are in the middle of another retail rollout right now to an additional 400-plus retail stores. This is very exciting as our total retail store count and national footprint could be in over 1,100 retail locations by the end of May. Again this is a testament to our innovative lease purchase finance approach at the point-of-sale and our mobile LTO technology, which is turnkey, integrationless, and pays the retailer immediately.

For Q1 2019, our average cost to acquire a customer was at its lowest amount for any fiscal quarter at $93 compared to $154 for the same period in 2018. Our success in reducing this cost was due to several factors, including continued optimization of our marketing and underwriting activities, coupled with a growing contribution from our B2B retail channel, which is a great source of lower acquisition cost customers for FlexShopper.

Repeat customers continue to be a growing segment of our business and represented approximately 45% of lease originations in Q1 2019, proving that our offering continues to resonate with consumers. The data points that I just addressed and others that Russ will discuss shortly all point to the fulfillment of FlexShopper's mission and vision. This includes providing non-client consumers access to better shopping options online and at retail stores. At the same time, we help our retail partners increase their sales with these consumers through our omni-channel lease purchase programs. I'm now going to hand the call over to Russ Heiser our CFO to discuss our financial performance and provide an update on our 2019 outlook. Then I have some final commentary before we open the call for some questions.

Russ Heiser: Thanks, Brad. As Brad touched on several of our key financial highlights, I'll focus on how those translate to our guidance for the year. Before doing that however, I want to make sure everyone understands the change in accounting treatment that you are seeing in our financials beginning this quarter. As discussed in the quarterly filing, ASC 842 has changed how we record revenue from leases. Historically, FlexShopper in the income statement reported all lease revenue in the revenues section and then the cost and expenses section had a provision for bad debt. In the MD&A section, FlexShopper then had a schedule that combined the two items and labeled it net revenue.

As a result of the accounting change in this filing and going forward, the provision for bad debt expense will not be broken out separately in the income statements, but netted in the revenue number. Therefore in the MD&A section we will report in a manner consistent with prior periods at breaking out the revenue line item into both total revenue and the provision for bad debt expense in order to facilitate period-over-period comparisons. In other words, gross revenue for this period would have been over $30 million in the old method versus the almost

$23 million reported in the current income statement due to netting against the provision for bad debt.

Once again it is all clearly laid out in the key performance metrics section of the MD&A. This is especially useful information when comparing our results to the various research reports on FlexShopper that report revenue in the historical fashion that is separating both revenue and bad debt provision in the income statements. In response to some inquiries regarding the prospectus filed last night, I want to be clear that the purpose of this filing is to provide a common share reserve for warrants that might be converted to common shares that stayed within the prospective itself. There are no plans to issue additional common shares.

Moving on to the company's results. I want to reiterate the comments from the last call in, which I covered the seasonality of originations and the resulting impact on EBITDA. The fourth quarter historically has the lowest EBITDA due to having the largest portion of annual marketing expense, while the first quarter has had the highest EBITDA historically as a result of having the smallest portion of annual marketing expense. With that in mind, let me move into the changes in management's guidance. As shown in the press release, which is available on flexshopper.com and in the Investor presentation, management has conservatively increased guidance again for both adjusted gross profit and adjusted EBITDA by $0.5 million to 25.5 million and four million respectively. Over the next quarter, we expect to observe continued growth in the B2B segment, which could provide additional upside for all of the guidance metrics. Here is Brad from some final thoughts.

Brad Bernstein: Thanks, Russ. Before I give my closing remarks, I just want to reiterate something that Russ mentioned which are--which is that there are no plans to issue additional common shares. In closing, we are very pleased with our first quarter results and the continued momentum we are seeing across all channels. With this momentum particularly in B2B as we mentioned in our prior calls, we are very focused on continuing to correlate our in-store and online LTO payment method wins into success with more retailers.

We are successfully fulfilling the company's original vision of being the pure-play, omni-channel, virtual lease-to-own company. We deliver our programs to consumers and retailers through a scalable technology platform that includes the largest lease-to-own marketplace and LTO e-commerce payment method and a mobile in-store LTO payment solution. We provide all of these offerings without carrying inventory, nor do we have brick-and-mortar stores, enabling us to provide value for both our partners and customers anywhere anytime. I'm gratified to see the hard work of our team members and our company's innovation to meet consumers and retailers needs translate into the excellent bottom line results we reported in Q1. With that, we'd be happy to take your questions. Thank you.

Operator: At this time, we'll be conducting a question-answer session. If you would like to ask a question, please press star one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment, please, while we pull for questions. Our first question comes from Theodore O'Neill, Ascendiant Capital markets. Please proceed with your question.

Theodore O'Neill: Thanks. Great quarter.

Brad Bernstein: Thank you, Ted.

Theodore O'Neill: Yeah. So, Russ, on the accounting for revenue. is it just simple enough if I just go back and collapse the doubtful account number into the gross line to restate the number in my model?

Russ Heiser: Correct. It's that simple. And like I said, it's broken out in the MD&A section, so you can see all the components.

Theodore O'Neill: Would you--are you going to always break it out like that going forward?

Russ Heiser: Certainly, for the–for at least this calendar year so we can continue to make sure that people are clear on the period-over-period comparisons.

Theodore O'Neill: Okay. So, I have a question about the cost to acquiring the customers. Great progress there bringing it down to $93. Is there a limit to how far--how low this can go? Do you have a target? How do you think about it?

Brad Bernstein: Yeah, so, we've expressed in the past that we would be–our targeted acquisition cost was much higher, but yes, this absolutely can go lower particularly with the influence of the retail that's been kicking in and obviously the growth of our B2B. With that, I'd like to add, and it's in the Investor deck, that not only was our retail B2B channel 26% of originations in the first quarter, but our online payment method was 10%. So both of those really influence our customer acquisition cost and obviously drives it down. As we've said in the past, we're at that point of the more we invest in marketing it mutes earnings, and right now we're balancing the continued growth that obviously we're doing with EBITDA and bottom line profitability. So, we–it's--we're kind of in a good position now where we can balance all those metrics.

Theodore O'Neill: Great. Thanks very much.

Brad Bernstein: Thank you, Theo.

Operator: As a reminder, we are now conducting a question-answer session. If you would like to ask a question, please press star one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment, please, while we pull for questions. Our next question comes from Richard Deutsche, National Securities. Please proceed with your question.

Richard Deutsche: Yes. Thank you for taking my, and thank you for delivering a jaw-dropping quarter. I have never seen a company come out of the gate with new projects as quickly as you have. And I'm looking at your B2B and also your online payment method, and it seems as if the profitability in these is pretty tremendous. Can you talk about the difference in the profitability between this and your regular customer accounts?

Brad Bernstein: Yes. So, we haven't really disclosed--even in our Investor deck, we haven't broken out the channels by profitability, but, conceptually, we will share that the in-store channel does have higher returns compared to our direct-to-consumer online channel, which is not unusual. E-commerce obviously has more risk the underwriting is tighter but the in-store face-to-face channel, the portfolio returns are higher with higher approval rates and obviously as we've also discussed a lower cost to acquire that customer.

Richard Deutsche: Yeah. Looks like your cost to acquire customers now that you've got your overhead in place is almost zero. Can you tell us how many accounts you have in the B2B so we can kind of keep a track on how they're growing just like your customers are growing? And can you do the same with this online payment method? That's where people checkout and choose FlexShopper as a payment method instead of PayPal and Discover. That seems to be another white-hot area investing in FinTech. And if you give us metrics each quarter as to how many accounts you have, I think that would be very, very helpful.

Brad Bernstein: Yes. So what--I think what--at this junction--and at the same time, you will be seeing additional metrics in coming Investor decks. But to answer your question, the growth in that channel has been obviously excellent. Coming from a year ago this time, we probably had 30 to 50 doors, and, as I indicated in the call prior, by the end of May, we will have over 1,100 doors. So, I--that--we're very pleased with that accomplishment. In terms of further color on your question, obviously a big focus of ours is to correlate our technology and success we've had over the last year in retail into more retailers, and we're very pleased with our pipeline as it is today.

Richard Deutsche: I just got one follow-up, and I'll get back in the queue. How quickly can you adopt and open these new accounts in both online and in B2B? Are there any issues that we don't know about in terms of how quickly a customer can sign on? And what issues they might encounter in wanting to sign on?

Brad Bernstein: So, Rick, that's a good question. Being at this now for over five years and really hitting that critical mass, but we've really listen to the retailers, and we heard them. And basically, that's where we're seeing a lot of success is we designed this integration-less approach. So, as you can imagine, retailers have a lot on their plate today. They're trying to maintain par in sales. And the last thing they want is another product in their store that requires an integration. So, with the mobile technology that we've created, it's very customer centric and pays the retailer at the point-of-sale just like any transaction without any back-end or front-end integration is music to their ears.

So, at the end of the day, we discussed this pilot months ago. Obviously, the pilot went very successful. We're now rolling out into 400 plus of their stores, and the quick adoption of that was because of the integration-less customer-centric approach, in addition to the merits of our lease purchase program for the consumer, which includes approval rates, no money down and so on, fewer application fields in our competitors, also. So that's a good question. We heard the retailer, we've listened, and we executed.

Richard Deutsche: Okay. Well I'll step back in the queue, but I maybe want to use FlexShopper as a payment method to buy some FlexShopper shares. That might be a good deal today. Thanks--thanks, Brad.

Brad Bernstein: Thank you, Rick.

Operator: Our next question comes from Michael Brcic, National Securities. Please proceed with your question.

Michael Brcic: Yeah. Hi. I'm new to the story--actually, Richard got me onto it. Can you just give some quick highlights on the balance sheet? Where we are? Do you have debt? And obviously you've talked about some convertible stuff. Can you just go through and give me a good sense of that?

Russ Heiser: Sure. So, well we can hit a couple of the highlights from the balance sheet. If you look at--finish the quarter with almost $3 million in cash almost $6.5 million--about $6.5 million of account receivable. I think probably what is most important is to understand that the lease merchandise outstanding on the balance sheet was a little over $28 million. Moving over to the liability side, we have credit facilities that are against that lease merchandise asset number of about $21 million. So, you can see there's still a pretty significant spread between the value of that lease merchandise on the asset side versus the debt--the credit facility that's against that asset. And then moving down the balance sheet you can see that we have a--the facility we've discussed in the past the Series Two Convertible Preferred stock of about $22 million and then sort of works its way through the common equity et cetera.

Michael Brcic: Okay. So, there's no other debt that's coming through or that you're holding?

Russ Heiser: Fairly typical sort of payables to vendors, et cetera.

Michael Brcic: Okay. So, there's no- nothing no bonds or anything like that outstanding?

Russ Heiser: Just the credit facility that is against our lease purchase assets.

Michael Brcic: Got it. Now those lease purchase assets are they--they're valued at a certain amount, but is that like a large charge-off or anything like that that happens with that in general? Or is that like a net number?

Russ Heiser: Well, as we've discussed before, so now our income statement actually shows revenue net of our provision for bad debt. So, any expectation of non-payments essentially flows through the top of the income statement.

Michael Brcic: Got it. Finally, just trying to figure out how it works, so like, I'm on Amazon, okay? And I buy something, and I got to pay up, and I have not noticed it before, but I guess I should look, it comes up as an option for me? Or do I have to sign up--I'm just trying to get a sense of how smooth the process is. Just click on that, and then it gives me a little one-page term of use or whatever, and I click okay? Or do I have to go through this whole process? Or do I have to sign-up first?

Brad Bernstein: So, in summary we have three channels. So, where you'll find our relationship with Amazon is on our marketplace. So, if you went to flexshopper.com, that's our direct-to-consumer channel where we market directly to non-prime consumers to basically use our lease purchase option. And then if you go there, as the largest lease-to-own marketplace we have fulfillment partners, which include Amazon, Walmart, Adorama, Electronic Express, overstock.com. And that's our relationship with Amazon. Our other channels--our B2B channels is where we are in stores. Basically where we're saving the sale after the consumer gets declined for the private label part of the store or primary credit. That's one B2B channel. And then I think what you're alluding to is we have another B2B channel where we are lease-to-own payment solution on third-party e-commerce sites not on Amazon but on other sites. So, when we say we're omni-channel we truly are.

We have three channels to offer consumers and give them access to lease purchase products. And then we have the same offering to our retail partners where they can increase their sales with non-Prime consumers through all three of our channels. Now obviously our marketplace partners are partners that we look to solicit to use in their stores or as a payment method on their site, too. The marketplace has, to some extent, been a leg up for us and an entry into a retail relationship with some of these larger retailers, and then we look to have dialogue with them about our in-store and online payment solutions.

Michael Brcic: Alright. Well, thank you very much. I appreciate it.

Brad Bernstein: You're welcome. Thank you.

Operator: Our next question comes from Steve Emerson, Private Investor. Please proceed with your question.

Steve Emerson: Thank you, and thank you for the great performance and a very clear and excellent conference call and press release.

Brad Bernstein: Thank you, Steve.

Steve Emerson: I've noticed some of the brokerage reports don't seem to hold your operating expenses constant. They just use a percent of revenue. I just want to clarify that on the income statement that salaries and operating expense are basically semi-fixed and as your revenue grows they will grow, but just moderately. Is that the correct way to look at it?

Brad Bernstein: Yeah. So, Steve, with your hitting upon the scalability of the model, and--.

Steve Emerson: --Yes.

Brad Bernstein: And yes, as we hit that critical mass, we originate more leases. We generate more gross profit. And the scaling is where--yes, to service those leases, we're going to need essentially more collectors and customer support. But the significant payrolls, the IT team, the marketing and so on, those are there. And they--.

Steve Emerson: --Okay. So we should include as this G&A, the marketing expense line, the $848,000. So, maybe the question is, as, let's say, revenue grows to your guidance levels of

$110 million, how much should this combined category grow for this year versus last year? I'm trying to get some sense of if revenue grows 25%, does your overhead grow, what, 5% 10%?

Russ Heiser: Sure. I think the best way to just think through that is to understand, as Brad mentioned, when it comes to the bulk of operating expenses they remain fairly flat some variability based upon growth but not particularly significant. The marketing item, as you touched on, is the one that has some variability associated with it. But based upon the expectations we've given in terms of originations and the lower customer acquisition cost that you're seeing now, especially with the growth of the B2B channels that we should expect a marketing number that is fairly flat versus last year.

Steve Emerson: Excellent. Now final clarification, I noticed that it looks like your marketing expense per non-store origination looks like it's declined significantly. Can you give us a number per lease versus last year non-store origination?

Russ Heiser: I think the best way to think through that is--yes, it is, The originations taking place outside of the B2B channels have continued to see a decline. There is obviously volume issues and different pieces that go into this, but should think about it as we talked about marketing staying somewhat flat versus the prior year, that we've also seen, despite the significant growth, that you should expect about a 30% decline in the cost of the non-B2B acquisition channel.

Steve Emerson: Okay. Thank you. And is there going to be a sharp increase in expenses in this quarter to finish rolling out the new 400 stores--tire stores that you added?

Brad Bernstein: No, it's been a very efficient rollout where essentially--there were central locations where stores have been coming in, and we have trainers. So, the answer is, no. No, there won't be a sharpened increase. It's been done very efficiently and effectively.

Steve Emerson: Excellent. Thank you, again.

Russ Heiser: Thank you, Steve.

Operator: Our next question comes from Michael Brcic National Securities. Please proceed with your question.

Michael Brcic: Hi. Just on the convertible preferreds [sp], there's, you mentioned, two series. Do you have the conversion price? And the--are there any like mandatory calls or anything like that where you can force them to convert?

Russ Heiser: Sure. There is a--the Series 1 is pretty close to our current stock price in terms of conversion value. The Series 2, the larger amount, has a conversion price of approximately $4 per share, and it has a mandatory conversion to common that's at a approximately 300% premium to that.

Michael Brcic: Okay, cool. Thank you again.

Russ Heiser: Thank you.

Operator: Our next question comes from Richard Doije [sp] National Securities. Please proceed with your question.

Richard Doije: Yes, thank you. On the payment option, how many companies are currently taking advantage of that?

Brad Bernstein: So, we haven't disclosed that, but I will say, compared to our peers, my understanding is we have more payment method integrations online than our peers.

Richard Doije: Okay. That's the other lease-to-own--is that what you're talking about?

Brad Bernstein: That's correct.

Richard Doije: Yeah, because the growth in that number in the B2B will enormously increase your profitability, and it's just--the more color you can give us on how many you have each quarter will help us project going forward.

Brad Bernstein: Yes. So, Rick, I totally agree with you. And obviously in the evolution of our company we--you could see how we've grown a nice direct-to-consumer repeat business, where we're now showing excellent progress in the B2B channels. And just to reiterate, I--we agree. That is a--the B2B online payment method in-store is a tremendous focus of ours, and obviously--we've got a sales team out there, and we're very satisfied with our pipeline today. So, we--every quarter we will be reporting more progress and nothing like reporting to everyone that we're in the middle of a 400-plus store rollout right now, so.

Richard Doije: I know some of these companies like to have you sign nondisclosures. But is there any reason why--competitive for other reasons why you wouldn't be disclosing some of these names or putting them alongside your public press releases?

Brad Bernstein: They do like to keep it close. So, for example, even in stores that their own private label credit card--when the consumer walks in the store, and in some cases, you're not going to see lease-to-own time to all over the store, because the way they like to handle it is truly to save the sale. So, in effect, you go in the store, they're offering the consumer their own private label credit card first customer gets declined. FlexShopper is the answer, it is the response. So yeah–no, they do like to keep it close to the vest.

Richard Doije: All right, any of your major competitors offering this, also? And could you name who your major competitor would be in that space?

Brad Bernstein: Well, in lease purchase finance, the largest would be Aaron's and their progressive division.

Richard Doije: Okay. Once again, thank you, Brad. Appreciate it.

Brad Bernstein: Thank you, Rick.

Operator: Again, that is star one to ask a question. Our next question comes from Michael Brcic, National Securities. Please proceed with your question.

Michael Brcic: Hi, again. The process of--some of the--they go in with the private level whatever--get declined. That's your relationship with that store. Is there a way you can get a relationship with the credit agency said these are declining, and then they can, as a general thing, recommend you?

Brad Bernstein: Yes. So, that's a good point, because one of the ideal things to do--and we've--something that we are looking to do is partner with basically credit companies and other finance companies that are--they're upstream, that have prime offerings, because then we would be approaching the retailers with one solution, instead of multiple solutions. The way that the industry has traditionally operated and continues to operate today is, we're all approaching retailers with the--with our own expertise in a certain segment of the consumer credit market. But, when we--I can tell you that in these relationships while we're not--we don't have a program together, when we do go into these retailers and we are working together, it is very cooperative.

So, for example, I could tell you that, not only in one of our retailers are we basically taking declines from the primary card in-store, but they're also--when the consumer gets declined for the primary offering online for that retailer, with that decline, there is a FlexShopper offer. So, there is cooperation, in the channels, once the retailer puts the products together--the offerings together.

Michael Brcic: Alright. Got it. Thanks, again.

Brad Bernstein: Thank you.

Operator: We have reached the end of the question-answer session, and I will now turn the call back over to Brad Bernstein for closing remarks.

Brad Bernstein: Thank you for joining us today. We look forward to speaking with each of you again on our second quarter earnings call. Thanks again.

Operator: This concludes today's conference. You may disconnect your lines at this time. Thank you for your participations.