# FINAL TRANSCRIPT

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## RCII - Q2 2005 Rent-A-Center Earnings Conference Call

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### OVERVIEW


**The Co. reported 2Q05 total revenues to have increased by 1.3%. 2Q05 diluted EPS declined 16.1% to $0.52 on a recurring basis vs. 2Q04. The Co. generated over $56m in operating cash. RCII anticipates 3Q05 total revenues to increase roughly 1% and diluted EPS of $0.38-0.42. For the full FY ending 12/31/2005, the Co. expects total revenues to increase roughly 1-2% and diluted EPS of $1.90-2.00. Q&A focus: New products, stores, and guidance.**

## CORPORATE PARTICIPANTS

**David Carpenter**
*Rent-A-Center - VP of IR*

**Mark Speese**
*Rent-A-Center - Chairman and CEO*

**Mitch Fadel**
*Rent-A-Center - President and COO*

**Robert Davis**
*Rent-A-Center - CFO*

## CONFERENCE CALL PARTICIPANTS

**Arvind Bhatia**
*Southwest Securities - Analyst*

**Dennis Van Zelfden**
*- Analyst*

**John Emerich**
*Iron Works Capital - Analyst*

**John Baugh**
*Legg Mason - Analyst*

**Alan Rifkin**
*Lehman Brothers - Analyst*

**Shaumo Sadhukhan**
*Basswood Partners - Analyst*

**Michael Christodolou**
*Inwood - Analyst*

## PRESENTATION

**Operator**

Good morning, and thank you for holding. Welcome to Rent-A-Center's second quarter 2005 earnings release conference call. [OPERATOR INSTRUCTIONS.] As a reminder, this conference is being recorded Tuesday, July 26, 2005. Your speakers today are Mr. Mark Speese, Chairman and Chief Executive Officer of Rent-A-Center; Mr. Mitch Fadel, President and Chief Operating Officer; Mr. Robert Davis, Chief Financial Officer; and Mr. David Carpenter, Vice President. I would now like to turn the conference over to Mr. Carpenter. Please go ahead, sir.

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**David Carpenter** - *Rent-A-Center - VP of IR*

Thank you, Dusty. Good morning, everyone, and thank you for joining us. You should have received a copy of the earnings release distributed last night that outlines our operational and financial results that we made in the second quarter of 2005. For some reason you did not receive a copy of the release, you can download it from our website at investor.rentacenter.com. In addition, certain financial and statistical information that will be discussed during the conference call will also be provided on the same website. Also, in accordance with SEC rules concerning non-GAAP financial measures, the reconciliation of EBITDA is provided in our earnings press release under the statement of earnings highlights.

Finally, I must remind you that some of the statements made in this call, such as forecast growth and revenues, earnings, operating margins, cash flow, and profitability and other business or trend information are forward-looking statements. These matters are, of course, subject to many factors that could cause actual results to differ materially from our expectations reflected in the forward-looking statements. These factors are described in our most recent annual report on Form 10-K for the year ended December 31st, 2004 and our quarterly report on Form 10-Q for the quarter ended March 31st, 2005, as filed with the SEC. Rent-A-Center undertakes no obligation to publicly update or revise any forward-looking statements.

I'd now like to turn the conference call over to Mark. Mark?

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Thank you, David, and good morning, everyone. While we are pleased to report second quarter results in line with our expectation, our business environment remains challenging, and our recent results, including July-to-date, are well below our expectations, and that, coupled with a softer outlook for the balance of the year, has caused us to lower our guidance for the remainder of 2005. We believe our customer continues to be pressured by the high energy costs, leaving less disposable income in their pockets, resulting in fewer deliveries per week on a per-store basis, approximately one less delivery per week, per store.

In addition, our delinquency rates continue to average approximately 0.5 to 0.75 of a percent higher than our desired goal of 5.99% past due at the end of the week. Our charge offs have remained at historical levels. However, the higher delinquency rates are leading to a slight increase in the number of returns per week, due to non-payment. These results are being experienced throughout the entire country, be it, to varying degrees, but all states are facing the issue.

While everyone knows that fuel costs have risen, let me share with you an historical perspective on average U.S. retail gasoline prices. The second quarter in 2004 of $1.92 per gallon was up over 26% from the second quarter 2003 of $1.52. The second quarter average in 2005 of $2.18 a gallon was up an additional 13.6% over the second quarter of 2004, and, in fact, the last three weeks, averaging $2.32, is up over 6% from the just-ended second quarter of this year. The fact is, a large segment of our customer base, having limited discretionary income, is being squeezed to make ends meet.

Of course the higher energy costs are also effecting our costs as well. By way of example, our delivery expense year-over-year is up approximately $200,000 a month on a comparable store basis, as is our utility expense. In total, both of those items are up over $250,000 a month, but, again, over $200,000 on a comparable store basis. Also, as we've mentioned before, we believe we are also being impacted by product evolution. The fact is, some of our low-end SKUs now make up a smaller piece of our overall business, in terms of the number of units on rent as well as the average rental rate of those units. Low-end consumer electronics, such as small portal TV's; the video category, including DVDs, VCR's and the likes; and stereos have experienced a decline on a per-store basis.

On a positive note, key products, such as appliances, computers, big screen TV's, and furniture have maintained or grown, obviously, not at the rate that the others have fallen off. One of our challenges, of course, is to be able to identify and offer new products and services to replace the others and augment our mature-store base.

Now, the question, of course, is -- What are we doing about it and where do we go from here? While we are always looking at and evaluating new product offerings, we are putting a greater emphasis on those key products I mentioned. By way of example, we're expanding the big-screen line to include DLP, LCD, and LCP. We're forcing more of the key products into the stores, be it appliances, furniture, or the likes. Now, when I say forcing, I mean more bulk purchases that lower our cost, insure product availability in the stores, and allow for some promotion or discounting to the consumer in an effort to drive more rentals in those products. With regard to new products, again, by way of example, we'll be testing musical instruments, including electric guitars, keyboards, and drums in 100-plus stores in just the next few weeks.

Of course, the strength of this Company remains our cash flow, and we're looking how to use that to leverage our store base by adding other services. Now, we've mentioned before looking at financial services to add to our stores, be it bill pay, payday loans, or the likes. And as noted in our press release, we just acquired a ColorTyme franchisee that successfully offers those products in their stores. Our intentions are to introduce those services in several dozen of our stores this year, with the belief that we could roll out on a larger scale beginning next year. We also believe that these services could drive additional new traffic to the stores, leading to increased rentals, as well as creating synergies between the two, being in marketing or advertising, management infrastructure, et cetera. Of course, as always, stock repurchases remain a viable option to return shareholder value.

On the expense side, as we've mentioned before, by and large, this is a fixed cost business, and as such, it is difficult to eliminate costs. What we are doing is more aggressively evaluating our underperforming and unprofitable stores. While our new stores are performing well and within our expectations, there are stores, be it older or past acquisitions, that are not. As again noted in the press release, 17 were consolidated last quarter, and one sold. While I'm not going to give a number here today, we are looking closely at all of the unprofitable stores and developing further action plans, including possible closures.

Now, on that front, let me remind you that in doing this, the net is a gain. There is minimal write-off involved with store closures -- lease locations, minimal lease hold improvements, some lease expense. The biggest asset, of course, is inventory, be it on rent or held for rent, and that can be moved to the surviving location.

We realize we have much work to do. The management team and our 16,000 co-workers are diligently working to address these issues. Let me go ahead and turn it over to Mitch to provide you a few other updates. Mitch?

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**Mitch Fadel** - *Rent-A-Center - President and COO*

Thanks, Mark. Mark's covered most of our key initiatives to improve performance, but let me just cover a couple more real quick. First, as many of you know, we recently restructured our advertising accounts. After a diligent interview process of numerous agencies, we now have a new agency of record, a new creative agency, and a new media buying agency, as we've split our marketing and advertising components up, using a best-in-class philosophy rather than a one-stop-shop format. Now, having completed this rigorous selection process, we've turned our attention, and we're now in the process of working with those new partners to evaluate all of our advertising components, including things like our creative message and positioning; our media placement, whether it be television or radio; our customer activation; customer reactivation programs; et cetera. So no -- no stone is going unturned when it comes to recharging our advertising programs or gauging their effectiveness. And as I mentioned, we've got a few new partners to work with on those fronts of looking at our advertising programs and gauging their overall effectiveness, and we're busy on that project as we speak.

So our recent price tests have not provided conclusive results. We are using what we have learned to date, and will continue to tweak pricing in certain areas to find answers to the pricing questions. Our numbers are pretty consistent, as Mark mentioned, whether there's a competitor or not, so we don't see this as a simple pricing game. And based on our price test results to date, that is not the clear answer at this point. However, we'll continue to move some test prices around to continue to learn where those price sensitivities lie.

As always, we continually look at our store operational execution. Our online training program is up and running, as we started off -- started that off with management training last quarter. Our entry-level programs will all be online by the end of August. Now this automated approach will help us gain efficiencies in developing our people, as we get new hires up to speed faster. This automated approach will also help us track our training and our training effectiveness on a person-by-person basis, which will lead to better employee retention, while improving our operational consistency.

Additionally, speaking of people, previously implemented HR initiatives are helping improve our turnover numbers, as those are down compared to last summer. And our national recruitment efforts are proving to be sufficiently effective in the area of staffing our stores. These initiatives, as well as the ones Mark mentioned, are being worked by everyone at a very expeditious rate, as we focus on only one thing, and that's improve our operating performance.

And with those additional initiatives, I'll turn it over to Robert for some financial updates.

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**Robert Davis** - *Rent-A-Center - CFO*

Thank you, Mitch. I'm just going to spend a few minutes here updating you on items pertaining to income statement, balance sheet, and cash flow statement prior to opening the call to questions here shortly. I'd like to mention and reiterate that much of the information that I provide, whether it's historical or forecasted results, will be presented on the recurring and comparable basis. Now, as the income statement items as outlined in the press release, total revenues did increase during the second quarter by 1.3%, while diluted earnings per share declined 16.1% from the prior year to $0.52 on a recurring basis. These results are primarily driven by the decline in our comps of 2.6%, offset by the revenue increase related to new and acquired stores, as the Rainbow and Rent Rite stores were in for the full second quarter this year, unlike last year.

Currently, there are 2,365 stores in our comp base, or roughly 82.5% of our total store count, 2,365 stores in our comp base. Furthermore, the stores in our comp base are, on average, 6.5 years old under our business model. And as most of you know, stores in our -- in our model generally mature around year five. And so, as mentioned in the press release and as Mark highlighted for you, our challenge largely centers on leveraging our real estate and infrastructure with additional product lines and revenue streams, and we believe our recent acquisition is a step in that direction.

Now as it relates to growth in our store base, for the last 12-month period, ending June 30th, we've opened 69 new stores, acquired 44 locations, as well as purchased accounts from 48 stores, while having consolidated or sold 67 stores over the last 12 months. EBITDA for the quarter totaled nearly 88.4 million, for a margin of 15.2%. And for the last 12 months, EBITDA totaled approximately 360 million, for a margin of roughly 15.4% on an LTM basis, which remains the highest in the industry.

Now from a cash flow perspective, the Company has generated over 56 million in operating cash since the beginning of the year, of which we expect this number to approximate 165 to 175 million for the year in operating cash, with free cash flow over 100 million, up to 120 million in free cash. Now, while starting the year with approximately 59 million in cash on hand, for the first six months, the Company has since utilized 24 million in capital expenditures, over 26 million in the acquisitions of stores and accounts, and nearly 62 million in debt payments, while ending the quarter with approximately 25 million in cash on hand. As you may recall, also during the second quarter, our cash flows were negatively impacted by the Griego litigation matter, which was funded during the second quarter roughly $38 million, as well as a higher cash tax obligation, as expected.

We did end the quarter with net book value of inventory on rent of approximately 574.1 million, and net booked value of held-for-rent items of 197.6 million, or 25.6, the overall inventory balance, which illustrates the softness we've been describing here today, as well as the timing of our strategy of making bulk inventory purchases to optimize cost. And while we feel our idle balances are currently higher than ideal, this is an area that we can manage and control going forward, by limiting where necessary, our purchases.

Now, at quarter end our consolidated leverage ratio was just over 1.7 times, while our interest coverage ratio was still very strong, in excess of 9 times. Debt to book cap at quarter end improved to 42.8%, with outstanding indebtedness at quarter end of just over 664 million. However, currently in the third quarter, it's 646 million outstanding indebtedness, as we drew on our revolver during the second quarter and paid that back, of roughly 18 million, due to the Griego settlement and the cash taxes, as I was referring to, paid that back already in the third quarter. So as it stands today, 346.5 million in senior term debt and 300 million of 7.5% subordinated notes, for a total of just over 646 in indebtedness. Our balance sheet remains strong, providing us with flexibility and dry powder, in order to address the current business climate.

And as outlined in the press release, in terms of guidance, we do anticipate for the third quarter of 2005, total revenues to increase roughly 1%, and diluted earnings per share to be between $0.38 and $0.42. For the full fiscal year, ending December 31, 2005, we expect total revenues to increase roughly 1 to 2% for the year, and diluted EPS in the range of $1.90 to $2.00. And as always, our guidance excludes any benefit associated with additional debt repayments, stock repurchases, or acquisitions completed after the date of the press release.

With that financial update, we'd now like to open the call to any questions that you may have.

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**David Carpenter** - *Rent-A-Center - VP of IR*

Dusty?

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**Operator**

Yes, sir?

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**David Carpenter** - *Rent-A-Center - VP of IR*

Would you please give the dial-in instructions for Q&A?

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## QUESTIONS AND ANSWERS

**Operator**

Yes, sir. [OPERATOR INSTRUCTIONS.]

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**David Carpenter** - *Rent-A-Center - VP of IR*

Okay, Dusty. Take the first question.

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**Operator**

And your first question comes from the line of Arvind Bhatia with Southwest Securities.

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**Arvind Bhatia** - *Southwest Securities - Analyst*

Can you hear me? Hi.

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

How are you doing, Arvind.

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**Arvind Bhatia** - *Southwest Securities - Analyst*

Good, good. Thank you. Just a few questions, here. First one -- Can we talk about the financial products or different new products that you're talking about, whether it's check cashing or payday loan type services? Can you speak to what kind of an impact that can have on your business, if you've done any analysis on, if implemented throughout the chain? And maybe you've been testing it in different places. Does it impact the comps, 1%, 2%? Or is that less than that, just to get a sense if, as you add these products and services, which direction your comps, or how positive could the comps ultimately get as a result of these products?

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Yes, Arvind, again, this franchisee that we just acquired is offering many of those services in their stores, be it payday and/or check cash, bill payment, money transfer. In this case, those particular stores are doing in excess of $20,000 a month in fees from those services. Again, our intention is to roll that out into a few dozen stores the balance of this year, get the learning we need within our store, and then think about how we may move that forward. Obviously, in many cases it's an ability to leverage our real estate where we're not incurring additional costs or much cost. In terms of the impact, I think you can kind of figure it out, whatever assumption you want to use, if we were able to duplicate their success or even, maybe, only got half of it, and then, how many stores we potentially could put it in, either because of it's within the geographical area or demographic area you would want to offer it, and/or the lease would allow us to do so because of others not competing, et cetera. And that number's still being vetted out, but, obviously, we're approaching it just in these states where the laws allow it, and, again, we want to test it here initially. But suffice it to say, it potentially could have some real upside for us.

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**Arvind Bhatia** - *Southwest Securities - Analyst*

How many stores do you think you could have it, just from a regulatory standpoint, how many stores would be covered?

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**Mitch Fadel** - *Rent-A-Center - President and COO*

Arvind, this is Mitch. It's -- from a regulatory standpoint -- there's 35 or 36 states, and I think it's 35 states, that have, what we would consider favorable legislation. The other states where they do have payday lending -- and by the way, all the stores that we just recently purchased are within a state with favorable regulation -- or legislation, I should say. In the other states, they've been -- most payday lenders in those other 15 or so states have been using the bank model that the FDIC has put under pressure recently --

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**Arvind Bhatia** - *Southwest Securities - Analyst*

Right.

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**Mitch Fadel** - *Rent-A-Center - President and COO*

-- is the best way to say it. So we focus on, for now, just those 35 states. And, obviously, by the time we got in those 35 states, hopefully the regulatory environment will get better in each of the other 15 states, so it'd be roughly two-thirds of our stores.

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**Arvind Bhatia** - *Southwest Securities - Analyst*

Two-thirds. And what about from a security standpoint, do you think your stores would have adequate security to allow this kind of product and service to be available? Or would you have to remodel stores in a meaningful way? And how quickly can all this happen? I'm just trying get a longer-term picture, how quickly you do this and once you start doing this and it's successful, I mean, then you talked about some of that impact. But give us some color from a security standpoint, if you could?

**Mitch Fadel** - *Rent-A-Center - President and COO*

Sure. There is -- there is some additional security necessary, because there's more cash in store. But this isn't -- I mean, the stores we bought, the ones we're learning from, and we've only had them about three weeks now, the majority of their revenue was in payday-lending type of business, not -- they did a little bit of check cashing, but the majority of their business is from payday lending, which is a lot less cash than a true check cashing business. And so, though there's some increase in security needs, it's not like a check cashing store where, you really have much different needs, where you might have $100,000 in there. In fact, most check cashing stores, you go if there now, if they don't do payday lending -- I'm sorry, if they don't do check cashing and they just do payday lending, the person's right behind the counter, and you don't have the bullet-proof glass kind of things, like you have in a place that does check cashing. So there is differences between just doing payday loans and check cashing. It's something our loss prevention department is looking at.

It's going to vary depending on where the store is, but that's not going to be a -- that's not going to be a tough thing to get beyond. We're looking at, in the 10 to $15,000 range to build that part of the business out, at least duplicating the model that we're learning from. Like I said, and as we go forward, we may tweak that -- but based on the stores we just bought, it's that 10 to 15,000 range. How fast we can do it? As Mark said, we're going to do a couple of dozen, maybe several dozen this fall, and then just learn from it. You know we're a pretty conservative Company. We'll walk before we run, make sure we have it figured out. We won't put it in 500 stores in the six months. And so we're going learn a lot more about it and go slow, but you're right in pointing out the fact that the impact long-term, as we get it in all the stores could be pretty large.

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**Arvind Bhatia** - *Southwest Securities - Analyst*

And would you -- do you think, initially, that you would need additional personnel?

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**Mitch Fadel** - *Rent-A-Center - President and COO*

The store -- the model that we bought, this ColorTyme franchise dealer, is doing pretty well at it, as Mark said, it's doing over $20,000 a month in the fees. They're doing that on average, with one more employee per store. And in some cases, where the volume's a little higher, they'd have a part-time employee in addition to that one, but generally, you can add one employee to our store.

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**Arvind Bhatia** - *Southwest Securities - Analyst*

Let me ask two quick ones here. First, we talked a little bit about the regulatory environment for the payday loan business, but what about the core rent-to-own business, any progress there? That's one. And then last one is -- Inventory held for rent, where do you see that falling at next quarter?

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Yes, I think your question on the core business, and certainly we're not -- I mean, we believe we can leverage our real estate to this customer base, and we've talked about these other products and services for sometime. This is kind of an introduction into it. We've got some learning to do, and it's not with the intent of getting off of our core business. We still believe this is a very viable business, and, obviously, we're focused more so on that than anything. Again, it's what other products and services can we bring to augment these mature stores, leverage the real estate and infrastructure we? The music instruments is one example of trying to get into some other products to do that.

Again, as I alluded to, there's a good possibility that by introducing these other products or services, whatever they may be, that you get increased traffic coming to the stores for those services and that, in turn, lends to enhancing the core service. And we'll, certainly, approach it from that perspective and when we look at marketing and advertising and so forth. And so we're very focused on the core business. The inventory levels, yes, as Robert alluded to, or as we mentioned, they are higher than we would like. It obviously speaks, A, to the softness in the business. We'd rather those products had been on rent rather than idle. From a store count perspective, and I think many of you have heard me talk about it this way in the past, from an operating perspective, we look at it, number of pieces per store. And we've said in the past, we like to maintain 160 to 165.

The fact is it was up to just over 175, the quarter ended. So we've got more inventory on hand. But, again, speak somewhat to the softness on the, not putting them on rent at this point. Also a little bit to the timing of some of those purchases, we talked about that last quarter. In the quarter just ended, we did some bulk purchases at appliances, we dropped-loaded refrigerators in the stores. We know that's a higher-demand item in the summer, and so, again, to make sure that we had those core products in there, we did do some bulk purchasing. But, again, as Robert alluded to, that's one of the things that we can manage in that -- by way of example, as I sit here, normally in the third quarter we might expect to buy maybe $120 million worth of inventory. And as we look at our levels today, what it suggests is that we'll buy, maybe it's 80 to $100 million worth of inventory. And so that in, by itself, will bring it down, just as we manage the inflow of what's coming in from this point forward.

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**Arvind Bhatia** - *Southwest Securities - Analyst*

Thanks, guys.

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**Mitch Fadel** - *Rent-A-Center - President and COO*

Yes, Arvind, as long as you don't have an obsolescence issue in the product, which we don't, it's just extra inventory that makes for itself as we buy going forward.

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**Mitch Fadel** - *Rent-A-Center - President and COO*

Right. And to further answer your question, I think we'd expect it to be -- that percent to be down slightly at the end of the third quarter, and then, really, we'd see the bigger drop in the fourth quarter when business really gets a lot better.

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**Arvind Bhatia** - *Southwest Securities - Analyst*

Right. Thank you.

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Thank you.

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**Operator**

Your next question comes from the line of Dennis Van Zelfden.

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**Dennis Van Zelfden** - *- Analyst*

Good morning, everyone.

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Good morning, Dennis.

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**Dennis Van Zelfden** - *- Analyst*

Going back to the purchased franchise stores, what was their level of base business? I ask because there had always been a fear that when you introduce any kind of new services into these stores that it may gum up their base business. How are they performing?

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**Robert Davis** - *Rent-A-Center - CFO*

Their rent-to-own revenue, our -- Dennis, was about the industry average, but maybe slightly higher than the industry average, but right in that range.

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**Dennis Van Zelfden** - *- Analyst*

So you don't -- that's not one of your fears as you roll this thing out? That it will negatively impact an already kind of flattish to down base business?

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**Mitch Fadel** - *Rent-A-Center - President and COO*

Well, and they didn't -- in those stores, being a franchisee, we've known -- we've known their history pretty well. And they didn't -- when they added them, they haven't these products and services since day one. They've added them in the last five years. And they did not see a decrease in business, if anything, they saw an increase in their rent-to-own side.

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**Dennis Van Zelfden** - *- Analyst*

Okay. Second question deals with if you were to add up all of the losses from the stores that are unprofitable, can you give us an order of magnitude of what that is?

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**Robert Davis** - *Rent-A-Center - CFO*

Well --

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Do we have it off hand?

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**Mitch Fadel** - *Rent-A-Center - President and COO*

We've got a lot of new stores in our unprofitable report.

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**Dennis Van Zelfden** - *- Analyst*

No, excluding all the new stores. I'm talking about the older stores.

**Robert Davis** - *Rent-A-Center - CFO*

On an annual basis? Well, to give you an example, Arvind --

**Mark Speese** - *Rent-A-Center - Chairman and CEO*

That's Dennis.

**Robert Davis** - *Rent-A-Center - CFO*

Or, Dennis, I'm sorry, the bottom 10% of our stores, June, year-to-date and what these 10%, they're just over 280 stores, are down 11.3 million in profit. Now, obviously, some of those are new stores we've just opened. 69 stores that we opened in the last 12 months, roughly 50 of those are going to be in there, because they don't start making a profit until month nine or ten.

**Dennis Van Zelfden** - - *Analyst*

That's an $11 million loss?

**Robert Davis** - *Rent-A-Center - CFO*

Loss.

**Dennis Van Zelfden** - - *Analyst*

Okay.

**Robert Davis** - *Rent-A-Center - CFO*

For new stores that are going to be in there, recent acquisitions, as well as, some just are unprofitable stores that Mark talked about. So that's kind of the magnitude. That's year-to-date for the six months.

**Dennis Van Zelfden** - - *Analyst*

Okay.

**Robert Davis** - *Rent-A-Center - CFO*

It's not 11 million in one month. It's 11 million for six months.

**Dennis Van Zelfden** - - *Analyst*

Right. Okay. You don't have the number excluding your new stores, do you?

**Robert Davis** - *Rent-A-Center - CFO*

No, not off the top --

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Not in front of us. We can get it.

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**Dennis Van Zelfden** - - *Analyst*

Okay. Thanks.

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**Operator**

Your next question comes from the line of John Baugh -- I'm sorry, John Emerich.

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**John Emerich** - *Iron Works Capital - Analyst*

Hi, thanks. Guys, couple unrelated questions. I'll ask them separately. First, just can you reconcile the, kind of, P&L guidance for the next quarter with the -- which appears, kind of, abysmal at first glance with the same-store sales guidance, which looks like an improvement over recent trends, if you will. I'm kind of staring at the release and in my model trying to figure out how to reconcile those two because they don't balance in my head necessarily.

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**Robert Davis** - *Rent-A-Center - CFO*

Well, I think, John, the same-store sales, although it looks better on paper, just given where we've come from recently in terms of the comps we've been posting, we have lowered our same-store sales guidance going forward. The guidance in the third quarter down negative 1 to negative 2. I think before last quarter, earlier in the year, we were expecting it to be somewhere flat to negative 1. And then, by the end of the fourth quarter in the positive range.

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**John Emerich** - *Iron Works Capital - Analyst*

Okay.

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**Robert Davis** - *Rent-A-Center - CFO*

So that's really the biggest driver, is that, although it looks better on paper, it's down from our previous guidance, and that's the biggest impact.

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**John Emerich** - *Iron Works Capital - Analyst*

Okay. Second question is just the -- the beauty of your, kind of, recurring revenue model historically is, obviously, now a saw that cuts both ways. You -- people return product and aren't taking something else, or new folks aren't coming in to take inventory to rent. It would seem to me that this is a -- I can't remember the average life of your -- what's the average life of your contracts, Robert?

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**Robert Davis** - *Rent-A-Center - CFO*

About 4.5 months.

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**John Emerich** - *Iron Works Capital - Analyst*

About 4.5 months.

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**Robert Davis** - *Rent-A-Center - CFO*

On each rental. The product itself is in the system roughly 19 months, rented three or four times, on average 4.5 months each time.

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**John Emerich** - *Iron Works Capital - Analyst*

Okay. Okay. I'm just trying to figure out if this isn't a -- well, I guess, with four months it -- it guarantees what you've guided to, basically, is a very difficult rest of the year. But I was trying to figure out if it didn't guarantee a -- kind of, a level of income like this almost for the next four quarters before you can kind of work your way out of it?

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**Robert Davis** - *Rent-A-Center - CFO*

No, I think -- I think you're right. Our business model is one that provides visibility. Obviously, the guidance that we've given takes into consideration what's happened here in the last six weeks or so, as well as a softer forecast going forward. And so as we sit here today, given the recurring nature of the revenues and the average life of the contract, from a top-line perspective, all that being in consideration, we're fairly comfortable with what we've given in the guidance.

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**John Emerich** - *Iron Works Capital - Analyst*

Really, your visibility, other than the historical rate at which you're able to keep something out on rent, which is now falling below that, your visibility's, really, then, like, 4.5 months. So we could get in the back half of the fourth quarter and it could not have improved or gotten worse, you couldn't tell that right now?

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**Robert Davis** - *Rent-A-Center - CFO*

That's right.

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**John Emerich** - *Iron Works Capital - Analyst*

I'm sorry, Robert, what was your -- what was the cash flow from operations for the quarter?

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**Robert Davis** - *Rent-A-Center - CFO*

For the quarter, it was down about 50 million.

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**John Emerich** - *Iron Works Capital - Analyst*

As a negative, as a use of cash?

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**Robert Davis** - *Rent-A-Center - CFO*

As a use of cash.

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**John Emerich** - *Iron Works Capital - Analyst*

That's a function of the 38 million settlement.

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**Robert Davis** - *Rent-A-Center - CFO*

And about 20 million or so from a cash tax perspective, as well as some of the bulk purchases and timing associated with those in the quarter as well. So --

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**John Emerich** - *Iron Works Capital - Analyst*

Did you make -- I thought the bulk purchases were in Q1. Did you make more this quarter?

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**Robert Davis** - *Rent-A-Center - CFO*

We did. Mark mentioned the refrigerators that we bought towards the end of the summer, or towards the end of the second quarter to ensure we had those products in the stores for the summer season.

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**John Emerich** - *Iron Works Capital - Analyst*

Right.

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Not as much as we did in the first quarter, John.

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**John Emerich** - *Iron Works Capital - Analyst*

Yes.

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

It was 12 million in appliances and then --

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**John Emerich** - *Iron Works Capital - Analyst*

Then this is going to sound kind of like a joke, but I'm quasi-serious. I'm trying to reconcile, that Mark did, the exercise you went through on gas prices. Gas prices are up year-over-year, they're up a little bit from the last quarter, but at least where I am, they've kind of been bouncing around this level, plus or minus $0.04 for the last three months. Did this -- did things really just fall off in the, kind of, the last two weeks of June? Was there -- I mean, can you -- would we be able to look at a day or two days where it just -- it just -- it dropped down and never came back?

---

**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Certainly, relative to our expectation it did, John. In July, we put in a lot of work for our plans for this summer in terms of promotions that we've introduced in the field, our trade-in date promotion that we have going on this month, some of the tools that we gave the operators and so forth, some of the price -- pricing that we put in place, our expectation for this month was quite a bit more than what we're realizing. And June ended up being a little softer than we expected as well.

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**John Emerich** - *Iron Works Capital - Analyst*

This is the part of my thinking that sounds like a joke, but not really intended be, is that -- Are you sure the problem is that folks are suffering gas prices, suffering the kind of tax from increasing gas prices and not doing actually better? I mean, I look at a store like Wal-Mart who's, granted, is probably, I don't know what the overlap is in your customer base, there's a lot of folks that shop at Wal-Mart that have never, would need never walk into a Rent-A-Center, but it is, as far as I can kind of tell, that the most public and highest end -- or serving the lowest end of the retail food chain above you guys, that they're doing so incredibly well, right through the end of June and -- ?

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Well, I think it's fair to say that Wal-Mart's done a better job of bringing in new revenue streams than we have, and that's been a weakness of ours, quite candidly. We have not done a very good job -- we've done a poor job of introducing, to date, anyways, new products or services.

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**John Emerich** - *Iron Works Capital - Analyst*

Okay.

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

And in Wal-Mart's case, I mean, we know grocery's been a big -- that's fairly new, still for them, and has been continuing to be their biggest growth vehicle. Extrapolating that, I'm not sure how they're doing on the other side of things. We do know, again, when we talk about some of these lower-end consumer electronics that continue to fall off, becoming more affordable at retail, somebody's getting the benefit of that, i.e., retailers, albeit an extreme example, but DVDs, $49 retail, and, in fact, six months ago they were free during the holiday season, nobody's renting DVDs. There's no need for it. Our stereo lines, as I mentioned, is down quite a bit. Home theater in the box retailing for $249 is an example, replacing big stereo systems that used to be $599.

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**John Emerich** - *Iron Works Capital - Analyst*

Mark, I think that's exactly my point. Things have gotten so cheap and --

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

In certain areas, yes.

**John Emerich** - *Iron Works Capital - Analyst*

-- and unemployment has gotten so low that I used to think about this as somewhat of a counter cyclical business, that you might have a portion of your historical customer base that's -- that can go out and buy that thing they used to rent from you. They don't need to rent --

**Mark Speese** - *Rent-A-Center - Chairman and CEO*

There's certainly a piece of it that probably can go do that on certain products.

**John Emerich** - *Iron Works Capital - Analyst*

Yes.

**Mark Speese** - *Rent-A-Center - Chairman and CEO*

I think it's also fair to say, and again, what we have to do a better job of is how do we expand who our customer base is that we serve? And many retailers think about how they tap into a lower -- the higher end of the lower segment, and we got to think about how we tap into the higher -- the lower end of the higher segment. If that made sense.

**John Emerich** - *Iron Works Capital - Analyst*

Yes.

**Mark Speese** - *Rent-A-Center - Chairman and CEO*

And that's where our time and efforts are being spent right now and how we think about getting into this different level of customer base to offset what's going on on the other side.

**John Emerich** - *Iron Works Capital - Analyst*

Right. Last question, and then I'll get off. Robert, free cash flow I think you said for the year 100 to 120. Nice, obviously, less than half of what it used to be. The -- walk me through, again, the tax issue. Does the negative compare versus the, kind of, Bush tax legislation benefits, is it -- does it last for one year or does it last us for as many years on the downside as you benefited from it on the upside, which was, like, two or three years, I think?

**Robert Davis** - *Rent-A-Center - CFO*

It lasts approximately three years at the reversal of some of the bonus depreciation on capital goods when the new tax law was signed in '02, the Job and Worker Creation Act -- I may have said that wrong -- but the majority of which is going to be paid this year, almost three-quarters of it, and then the other 25% are paid in '06 and '07.

**John Emerich** - *Iron Works Capital - Analyst*

Okay. So there's an impact, but it's smaller in '06 and '07 than it was in '05?

**Robert Davis** - *Rent-A-Center - CFO*

Right.

**John Emerich** - *Iron Works Capital - Analyst*

Okay. What's the order of magnitude? I won't hold you to it, the dollar change between this year and '06 that you're looking at?

**Robert Davis** - *Rent-A-Center - CFO*

I think it's roughly 70 million-ish in total, of which 50 million, 40 to 50 million will be paid this year and the other 20 million or so paid in '06 and '07.

**John Emerich** - *Iron Works Capital - Analyst*

So maybe 10 in '06 and 10 in '07?

**Robert Davis** - *Rent-A-Center - CFO*

More in '06 and the remainder in '07.

**John Emerich** - *Iron Works Capital - Analyst*

So the differential could be as much as $30 million next year relative to this year?

**Robert Davis** - *Rent-A-Center - CFO*

Right.

**John Emerich** - *Iron Works Capital - Analyst*

That's all I had. Good luck, guys. Thanks.

**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Thank you.

**Operator**

Your next question comes from the line of John Baugh with Legg Mason.

**John Baugh** - *Legg Mason - Analyst*

Good morning.

**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Hi, John.

**John Baugh** - *Legg Mason - Analyst*

I guess just a cleanup on this cash flow thing, because I want to get the -- all the components clear, and if we could just look at an annual for '05 and to the degree you have it, for '06. Your litigation payment was 38 million, correct?

**Robert Davis** - *Rent-A-Center - CFO*

That's correct.

**John Baugh** - *Legg Mason - Analyst*

You're expecting cash taxes to be 40 to 50 million above reported taxes, is that correct?

**Robert Davis** - *Rent-A-Center - CFO*

Not exactly. Reported taxes will be around 90 million, I believe, and we'll have about 25 -- 25 million, or so, above that in cash taxes.

**John Baugh** - *Legg Mason - Analyst*

Okay. 25, okay. Your CapEx for '05?

**Robert Davis** - *Rent-A-Center - CFO*

Roughly 60 million.

**John Baugh** - *Legg Mason - Analyst*

60?

**Robert Davis** - *Rent-A-Center - CFO*

Yes.

**John Baugh** - *Legg Mason - Analyst*

And, then, your net investment in rental merchandise has really changed around, sounds like it's going to drop a lot in 3Q. Where does that end up for the year?

**Robert Davis** - *Rent-A-Center - CFO*

We're expecting about 10 million net investment in rental merchandise.

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**John Baugh** - *Legg Mason - Analyst*

Net investment, okay. And what about '06? Have you got a CapEx budget and feel for net investment and inventory?

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**Robert Davis** - *Rent-A-Center - CFO*

John, not at this point. We haven't given any guidance for '06, and think the largest part that is going to be predicated on how this recent acquisition performs during the back half of the year and how quick we want to ramp that up next year, so that number can change one way or the other a significant amount, I would presume, and so I don't want to make any commitments at this point.

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

That would be similar to this year.

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**Robert Davis** - *Rent-A-Center - CFO*

Yes, absent that, it'd be fairly similar to this year.

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**John Baugh** - *Legg Mason - Analyst*

Okay. And they then on -- to your question, I think you made the comment, Mark, that it's just tough to cut costs. Is there anything you do -- obviously, you have fixed expenses to a large degree at the store level with things like leases. I don't know if personnel's fixed, but you're chasing your tail there if volumes are dropping, you're letting people go. It's hard to stay in front of that. Is there anything, if the comps continue to stay in the slightly negative territory, I'm looking at your SG&A guidance, and you're losing a lot of leverage. Is there anything you can do on that front going forward, or is it just, we just have to get the comps at least stable, if not positive?

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Well, you did hit it on the head and I alluded to it. It is, by and large, fixed costs on the labor line. I mean, I think you heard us say, as a general rule, we don't have a lot of labor in the store to begin with, in that five people, and cutting one or a half a one, reducing your work force 10 or 20%, for a 2 or 3% comp. Now, part of that self-regulates, in that larger stores, you may recall we've talked about our model, dictates at what point a store may get a sixth, seventh, eighth employee or a third truck. And to the extent they were to back up, such that they would fall within one of those other guidelines, it would regulate itself, and some of the cost would come out. So I guess it floats a little bit, depending on the volume of their store.

A lot of the other line items, we're certainly been looking at all of them, whether it's, now delivery, what do you do? Again, we've only got a couple of trucks, and that's dictated or mandated by deliveries and maybe it goes down a little bit if they're not on the road so much, but, again, it's not as if you can take cost out. Obviously, as we look at our underperforming, unprofitable stores, there's some synergies, I guess, or, certainly, some costs that can be taken out of there, potentially, real costs, in things that are having a dragging on earnings, also, and as a starting point, that's where the bigger focus is being put right now.

Advertising, we've heard that question in the past, and generally speaking, as a Company our size, our advertising budget's about 4.5%, or so, of our revenue, which is not egregious in any sense. Some might question whether we're spending enough. And one of the things that we're doing, Mitch talked about some of the rebundling, and so forth. And we're not at that point, but, certainly, part of that also includes looking at the dollar spends and the adequacy of it, whether it's too much or not enough, and how you value that return on that investment and so forth. But what we really need to do, John, and where the focus is, certainly, we're looking at costs in the interim, and looking at these unprofitably stores, but more than anything, it's about how we drive the top line, and that's where most of the focus is being spent.

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**John Baugh** - *Legg Mason - Analyst*

Okay. Couple of other things quick. Did your ad spend change in the last six months as a percentage of revenue with all the shopping for new media buy, new creative, and all that, did you pull back?

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

No, it didn't -- really the net spend was about the equivalent of what it has been. We did go through a transition with the prior agency working out and the new one coming in, but net, net, I mean, it might have been a few more dollars in fees, but it was very minimal. I mean, generally, no. There was no change.

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**John Baugh** - *Legg Mason - Analyst*

Okay, and did the Dell program, speaking of new products and services, the Dell thing just isn't working, is that the bottom line?

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**Mitch Fadel** - *Rent-A-Center - President and COO*

Well, I mean, we're still working on that. The -- we're talking to Dell now and continuing to work on that program, as far as getting their referrals and so forth. So that -- we haven't found the secret to making that work yet, but both us and Dell are still working on that and we haven't given up on it yet.

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**John Baugh** - *Legg Mason - Analyst*

Your conversion rates have been a lot lower than you thought, is that fair to say, or -- ?

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**Mitch Fadel** - *Rent-A-Center - President and COO*

Yes, we're looking at -- we're looking at retesting some of those with a different strategy from a cost center standpoint, and we're working through that with Dell now.

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**John Baugh** - *Legg Mason - Analyst*

Okay, and last question, maybe for you, Mark, again, back to the pricing. I don't -- I'm confused. I mean, you tested it. Basically, hear that you -- what you said, it's inconclusive, but, I don't know, you said a bunch of other things and I just didn't really understand. Where are we with that? Is it something you're really going fool with in the future? Or is it, hey, we're got a four-turn model, and we got to make that work, that's what works for us and we're not going to make it up in volume by discounting?

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Yes, what we were saying is that it really has been inclusive. It's been just right at a year. And the fact is, be it those two states, while we've seen a little lift, and I mean a little lift in BOR, it's been, obviously, at the expense of less revenue, because of less revenue per unit. In fact, I guess, probably the best way to answer it, John, when we look at the Company as a whole and granted our margins are down a couple of percent from a year ago, those two states are down more than that. And so while they may have gained a couple of more units or not lost as many, they, certainly, and that was one of our concerns all along, is you've got to have that added lift above and beyond what you're going to give up, and it hasn't worked. Now, we've been looking at specific products within that. And to the extent certain products have behaved differently, i.e., maybe one of the appliances, we can see that there was a marked difference. And, then, that's what we're doing, is really -- I think that's what Mitch was alluding to -- is some of that learning may have application, but the concept itself, in its entirety, no, it's not, it's not a price issue.

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**John Baugh** - *Legg Mason - Analyst*

Yes, great. Thanks for answering my questions.

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

You bet.

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**Operator**

Your next question comes from the line of Alan Rifkin with Lehman Brothers.

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**Alan Rifkin** - *Lehman Brothers - Analyst*

Yes, thank you, very much. Couple of questions, if I may. Mark, you mentioned that July was well below your expectations. Does your guidance for third quarter earnings and comps assume that business in July improves, or that we just see a similar effects in the next two months, given what we've seen already in July?

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Well, it certainly has June and July's results embedded, and we did, I think, as I alluded to, softened our outlook, if you will, for the balance. And so where our expectation may have been one thing in August or September, as an example, it's now something a little less than that, based on, again, what we're continuing to see and hear, even though, again, we think we got -- we're working on some things that will turn it around, until we see those come through to fruition, we're not making assumptions that it's going to change in a big way.

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**Alan Rifkin** - *Lehman Brothers - Analyst*

Okay. Mark, like, philosophically, can you just maybe shed a little color on your decision at this point in time to test the financial services? Do you think that it's just a logical extension, given your customer demographics, or do you possibly see, less potential inherent growth in the business lines that you're already in?

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

No, it's really the first, Alan, and think you and everyone else, we've talked about this for sometime now. This isn't -- we didn't wake up yesterday, so to speak, and say, boy, we need to go do something else. Rather, we've been looking at this and other products and services for quite some time and, obviously, when I say that, how do you augment the store, how do you enter into those? This fits a small acquisition, but it affords us an opportunity to get into it. We do think -- I mean, what we've seen and heard and what we have learned here with this operator, there is some overlap between the customers, not significant, it may be 30%, but certainly a segment of this customer base uses it.

More than anything, I think where we can have success with it is when you think about the nature of the transaction, like ours, it's very much relationship-driven. The frequency, high repeat, customer interaction, and that's something that we do successfully day in, and day out. And so we do think it's a natural extension of what we're doing and, again, it doesn't have application in all stores or all states, but it's one that we've been looking at for some time and do think is a natural fit and can augment our stores, and, again, not at the expense of our core business. And what we've seen supports that thus far.

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**Mitch Fadel** - *Rent-A-Center - President and COO*

And remember, Alan, we -- this is a ColorTyme franchisee we're talking about, so we've been able to watch him add this to his business and watch his results for quite some time now. This wasn't an acquisition where all we know about it is what the seller shared with us the last 30 days or something like that.

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**Alan Rifkin** - *Lehman Brothers - Analyst*

Right.

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**Mitch Fadel** - *Rent-A-Center - President and COO*

I mean, this is a franchisee. And, obviously, one of the benefits of having that franchisee, maybe one of the biggest ones, is that they'll go out and try things. As you probably know, franchisees tend to go out and take a little more risk than larger companies. And so we've been able to watch what he's done, and he's been able to make it an extension of his current business, not distract from his current business at all. His rent-to-own business has grown since he's been in payday lending.

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**Alan Rifkin** - *Lehman Brothers - Analyst*

Okay. Thank you. And one more question, if I may, with respect to your evaluation of the underperforming stores. If at all possible, can you just shed a little bit more color, maybe with respect to what proportion of your stores, whether they're mature overall or are achieving your hurdle rates, or do you think that as you look at the potential for closing underperforming stores, is it a particular markets that may be -- are dragging some of the performance down? If you could just give us any more color there, that would be appreciated.

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Yes, let me give you a little bit. They're not geographically per se located in one area. I mean, we've got this throughout the country. In some cases, again, these are stores, and we've talked about this in the past and we've consolidated some of these in the past for this same reason. It was an acquired store, where we had a pretty good presence in the marketplace, but let's leave the store open and put our business model in and see if the market can support an additional store. And quite a few of these, the case is, no, we don't need four or six or three or whatever that number is within that market. And we've cannibalized ourself a little bit further by keeping that one open and now we've got so many, such that one of them is not doing well and/or it's had an impact on the three or six, and we can enhance it by consolidating, and so there's certainly some of those.

The number, and I know Robert threw out the bottom 10. In fact, that is the losing stores. I mean, when you get to the next 10, they're not losing money, I mean, it's really --

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**Alan Rifkin** - *Lehman Brothers - Analyst*

Right.

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

And so that 280, there's 70, or so, new ones in there, there's probably somewhere similar number of acquisitions within the last 12 or 15 months that are in there also. So you really cut that number down to half or less when we look at stores that have been under our business model, and some of these, we opened it ourselves maybe three years ago, and now realize, well, we didn't need or it was a bad location, and so we need to revisit it, and/or maybe one that's even older than that, but for a variety of reasons are not performing where they need to be. And we're looking at those as well, but it's -- again, I don't want to put out a definitive number. I mean, we're still kind of working through it.

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**Alan Rifkin** - *Lehman Brothers - Analyst*

Right.

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

And you got to look at each one as a standalone. It's not as simple as, okay, anybody that's doing X or Y, you just do it. You got to really dig in and understand why and what can be done differently. And that's what we're doing, but --

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**Alan Rifkin** - *Lehman Brothers - Analyst*

Okay. So, Mark, you do think it's more of a function of, like, one-off reasons, including, like, cannibalization as opposed to, maybe, one of your competitors doing a better job against you?

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Yes, yes.

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**Alan Rifkin** - *Lehman Brothers - Analyst*

Okay. Thank you very much.

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Thank you.

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**Operator**

Your next question comes from the line of Michael Christodolou with Imwood.

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**Michael Christodolou** - *Inwood - Analyst*

Good morning, gentlemen. Couple questions. First on the ColorTyme franchisees -- the franchisee that you bought. Can you give us a recap of the multiple of monthly revenue paid? And how do you think about paying for those extra financial service fees?

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**Mitch Fadel** - *Rent-A-Center - President and COO*

It came in line with our normal multiples. In the -- in most of our acquisitions are done in the, oh, depending on the size of stores, as little as 6 to 7 times monthly revenue, and as high as 10 times revenue, and that was in that range. And there -- extra revenue on the financial services was calculated from our standpoint, and similar to rent-to-own revenue, even though the cost is actually less in that part of the business, but, certainly, we're closer -- we're at the high end of our range paying for that business, but it was in that -- within that range of $0.60.

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**Michael Christodolou** - *Inwood - Analyst*

Okay. And, again, that was 27 stores?

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**Robert Davis** - *Rent-A-Center - CFO*

Correct.

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**Michael Christodolou** - *Inwood - Analyst*

And each store is doing, is that 20,000 a month? That's per store?

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**Robert Davis** - *Rent-A-Center - CFO*

The average is slightly over 20,000 a month per store. There's some higher and some lower, but the average is a little bit over 20,000 in fees.

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**Robert Davis** - *Rent-A-Center - CFO*

Just the financial services.

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**Mitch Fadel** - *Rent-A-Center - President and COO*

The fees, off of the financial services, right.

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**Michael Christodolou** - *Inwood - Analyst*

Okay. 20,000 in fees. So 250 -- a quarter of a million of a year, basically.

**Robert Davis** - *Rent-A-Center - CFO*

Per store.

**Michael Christodolou** - *Inwood - Analyst*

Per store.

**Robert Davis** - *Rent-A-Center - CFO*

On the fee -- on the loan fees side.

**Mark Speese** - *Rent-A-Center - Chairman and CEO*

That's not inclusive of the rental fees, that's just the fee side.

**Michael Christodolou** - *Inwood - Analyst*

I'm sorry. Say that again.

**Mark Speese** - *Rent-A-Center - Chairman and CEO*

That is not inclusive of the core rent-to-own revenue. That is simply the fee revenue.

**Michael Christodolou** - *Inwood - Analyst*

Okay. Fair enough. Fair enough. And just a little more elaboration on the comps. So it does look like your second quarter as reported, the down 2.6, was better than the negative 3 to negative 4 that you thought you'd have, but it does look like it deteriorated through, kind of, May through June, into July. Is that a fair description?

**Mitch Fadel** - *Rent-A-Center - President and COO*

Well, certainly, more June and July, as well as because of what's happened in June and July as we look through the rest of the year, we've lowered our forecast there. It does -- I understand what a lot of people are thinking. It seems like a big drop for just two months, but the last two months' color really goes through our model for the rest of the year.

**Michael Christodolou** - *Inwood - Analyst*

Right.

**Mitch Fadel** - *Rent-A-Center - President and COO*

And that's what drops it as much as we dropped our guidance.

**Mark Speese** - *Rent-A-Center - Chairman and CEO*

And I -- quite honestly, Michael, our comp, there's stores coming in and out every quarter because of current acquisitions or past acquisitions and when we consolidate, they get pulled out, and it's a little bit of a moving target. I think we do a pretty good job of estimating it, but, unlike typical retail or what you might think of a normal comp is -- if I know I sold X last year and I think I'm going to sell out Y this year, it gets you to a definitive number. In our case, because there's movement of stores within the comps, coupled with, it's a quarterly and if we do very good at the front end of the quarter, that has a different impact than if you did poorly at the front end or conversely the back end, good or bad. And so there's a few more moving pieces there, and it's -- but, yes, it's a little bit better, but I think the other big answer is what Mitch alluded to. It's just, given what's going on now and how that factors into the future is what really drives it.

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**Michael Christodolou** - *Inwood - Analyst*

I understand, and back in the first quarter, I recall when you had the negative 5 comp, there was some explanation that there was one less Friday in the month. Were there any calendar factors at work in the second quarter, or are there any in the third or fourth quarters that you're making a special compensation for in terms of the revised guidance?

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**Robert Davis** - *Rent-A-Center - CFO*

You're right. In the first quarter, we had an extra Friday, which was about a 1.5% on our negative 5 comp. If the business days lined up the same, the first quarter would have been more like 3.5. The only difference in the third and fourth quarter is the third quarter we have a Friday instead of a Thursday, which is better from a comp perspective. In the fourth quarter, we have a Saturday instead of a Friday, which, again, is better from a comp perspective.

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**Mitch Fadel** - *Rent-A-Center - President and COO*

But not like the first quarter, where there was a whole difference in a day.

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Right.

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**Mitch Fadel** - *Rent-A-Center - President and COO*

It's just a gain or loss --

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**Mitch Fadel** - *Rent-A-Center - President and COO*

The calendar shifts, but there's no gain or loss in either the second, third, or fourth quarter, Michael.

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**Michael Christodolou** - *Inwood - Analyst*

Okay. And in terms of the new guidance, is there any thought that comps could be positive in the fourth quarter, or I'm just trying to, kind of, interpolate the new guidance with the flow of the last seven months that we basically know.

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**Robert Davis** - *Rent-A-Center - CFO*

Not as we sit here today. The guidance, best case would be flat in the fourth quarter, more likely, down 1 to, maybe, 2%. But the best case is flat.

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**Mitch Fadel** - *Rent-A-Center - President and COO*

The business would certainly have to turn quickly for that to happen.

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**Michael Christodolou** - *Inwood - Analyst*

Okay. So flat to negative 1 to negative 2. Flat, best case, but negative 1, negative 2 likely.

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**Robert Davis** - *Rent-A-Center - CFO*

Right.

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**Michael Christodolou** - *Inwood - Analyst*

And that's versus the negative 3.7 last year?

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**Robert Davis** - *Rent-A-Center - CFO*

Correct.

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**Michael Christodolou** - *Inwood - Analyst*

Okay, just a few more questions. What dollar value EBITDA for '05 now foots with the $1.90 to $2.00 in EPS? Is it that 35 million, basically, 35 million off the numbers, the 375 to 395 you used to guide to?

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**Robert Davis** - *Rent-A-Center - CFO*

The EBITDA range is now around 3.25 to 3.40 for the year.

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**Michael Christodolou** - *Inwood - Analyst*

Okay. And net cash interest still 40 million?

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**Robert Davis** - *Rent-A-Center - CFO*

Correct.

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**Michael Christodolou** - *Inwood - Analyst*

Okay, and total tax is still 130, cash taxes.

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**Robert Davis** - *Rent-A-Center - CFO*

Roughly 120.

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**Michael Christodolou** - *Inwood - Analyst*

120, okay.

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**Robert Davis** - *Rent-A-Center - CFO*

Obviously, as our earnings come down, there's some impact there, so.

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**Michael Christodolou** - *Inwood - Analyst*

Okay, and I think I know the answer to this, but you did not buy any stock back in the second quarter?

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

No, we did not.

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**Michael Christodolou** - *Inwood - Analyst*

Okay.

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**Robert Davis** - *Rent-A-Center - CFO*

Yes, we had very, very little.

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

I guess we did have the --

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**Robert Davis** - *Rent-A-Center - CFO*

167,000 shares, or something.

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**Michael Christodolou** - *Inwood - Analyst*

Okay.

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**Robert Davis** - *Rent-A-Center - CFO*

But we still have about, roughly 60 million in availability under our Board authorization, and up to, close to 190 million under our covenants with our debt agreements.

**Michael Christodolou** - *Inwood - Analyst*

Okay. And a couple of other things. Back in the first quarter, I think, Mark, had you referred to this last quarter that, pay offs were up in the first quarter, so you lost the residual. Where are you seeing pay offs now fit within the -- ?

**Mark Speese** - *Rent-A-Center - Chairman and CEO*

It's actually, and I think I alluded in the call last quarter, that they were up in the first, but starting to normalize, if you will, and as we sit here today, that continues to be the case. They have normalized, so that -- that's not -- that's not our issue, Mike.

**Michael Christodolou** - *Inwood - Analyst*

Okay.

**Mark Speese** - *Rent-A-Center - Chairman and CEO*

I can tell you that pay offs are up. It's more a little bit, again, that slight weakness in delivery and the slight increase in pickups. It's not the payout issue.

**Michael Christodolou** - *Inwood - Analyst*

Okay. And the delinquencies, which, I guess, you're shooting for sub-6 at the end of the month, and it sounds like it's about, what, 6.5, maybe, 6.75. Are you seeing that in any particular products? In other words, is it the big, big screen TV's and refrigerators where there's a delinquency, or is it in some of the lower price points?

**Mark Speese** - *Rent-A-Center - Chairman and CEO*

No. It, again, that, 6% goal is really the end of the week.

**Michael Christodolou** - *Inwood - Analyst*

Oh, end of the week, okay.

**Mark Speese** - *Rent-A-Center - Chairman and CEO*

And -- because we manage collections daily, and most of our customers pay weekly. So 6% end of the work week, being Saturday night our goal. And you're right, it is 6.75%. And it's -- we do look at our -- I mentioned our losses have run at historical levels, so even though the delinquencies are up a little bit it, is not translated to increase in losses. It's increase in pickups, but it's generally across the products. I mean, when we look at the losses that we do incur, we do break it out, specifically, by products, and it's not as if one is jumped off the page more than the other or within historical averages, if you will. So it's not a product-specific issue, no.

**Michael Christodolou** - *Inwood - Analyst*

Okay. And just two other questions. Back on the ColorTyme franchisee you bought, is any key management staying with that or any key personnel with respect to the financial services piece staying with that?

**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Mitch, do you want to take that?

**Mitch Fadel** - *Rent-A-Center - President and COO*

Yes, all of the key personnel on the financial services are staying on, as well as the consulting agreement with the prior owner, as we go through this. He's at our -- from a needs standpoint, we can use his knowledge and so forth as we go forward as well.

**Michael Christodolou** - *Inwood - Analyst*

Very good. And my last question, really, for Mark and Mitch, I mean, you two guys are young guys, but I think you probably got, what, 50 years in this industry between the two of you. And I'm just curious, I guess, qualitatively, you've seen other cycles, but have you seen other cycles where we've got such a confluence of, either lack of new product or deflation in certain key low-end consumer electronics products, or some of the fuel issues, the employment issues? I mean you've seen cycles before. Where does this one kind of fit in your gut?

**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Yes, been around a long time and have been through those various cycles before. This one is a little bit different, unique. There's a lot of, at least from my perspective, there's a few different things going on at one time, and you alluded to it, be it, some of the product evolution or deflation that we're seeing some of the product lines, the rising costs as it relates to discretionary income to our consumer. It ranks up there with one of the more difficult ones.

On the same hand, I guess I would tell you my outlook hasn't changed. My perspective on things hasn't changed. My belief in this business, this model and this customer haven't changed. On the same hand, I guess what's a little bit different is we're a much, much larger Company. And, candidly, when we went through some of these other things in the past, being smaller and growing more rapidly, we were able to absorb some of it also, and that's, obviously, a little bit more challenging, just given our size and maturity within the business.

**Michael Christodolou** - *Inwood - Analyst*

Well, thank you, and continued good luck.

**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Thank you.

**Operator**

Your next question comes from Shaumo Sadhukhan with Basswood Partners.

**Shaumo Sadhukhan** - *Basswood Partners - Analyst*

Hi, guys. My question has to do with this issue -- actually I have a few. But the first one has to do with this issue of the lower-end electronics and the fact that people can sort of buy some of the stuff now and don't have to rent from you. Can you give us a sense of what the order of magnitude difference in comp is between those categories compared to, sort of, the Company average comp?

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

I can give you a couple of examples. The video, which, again, is our DVDs and VCRs and recorders, and the likes, on a year-over-year basis, our revenue is down approximately 9%. In the stereo line, again, shelves, racks, albeit it now includes home theater in the box, those are, obviously, at lower price points. On a year-over-year basis, those are down over 15%. Conversely, computers are up over 13%. Furniture's up over 4%. Appliances are up, et cetera.

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**Mitch Fadel** - *Rent-A-Center - President and COO*

I think another way to look at that, Shaumo, is if you think about the product's Mark's talking about, the lower-end products that they make up about 25% of our inventory, or used to make up 25% of our inventory. All of our negative comp is there.

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**Shaumo Sadhukhan** - *Basswood Partners - Analyst*

Okay.

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**Mitch Fadel** - *Rent-A-Center - President and COO*

So if you got a negative 2.5% comp, about 10% coming out of those cumulative categories, being only 25% of our overall inventory, it's pulling down the comp 2.5% or so. It would be a good way --

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Yes, we've got a few less units on rent, and those that we have are at lower price point than what they were historically.

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**Shaumo Sadhukhan** - *Basswood Partners - Analyst*

So all of the other categories, or most of the other categories, such as big screen TVs and furniture, the stuff that's 1,000 and $2000 to buy, or whatever --

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Yes.

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**Shaumo Sadhukhan** - *Basswood Partners - Analyst*

-- all that stuff is comping positively at this point?

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Yes. We have, in fact -- yes, at least flat, if not up. I mean, big screens, by way of example, we have more big screens on rent today on a per-store basis than we did a year ago.

**Shaumo Sadhukhan** - *Basswood Partners - Analyst*

Right. Okay. So is this something that's -- so this is really the first time I've heard you guys sort of highlight this issue in a big way on a conference call or in a press release. Is this something that's -- you're sort of realizing that's only happened the last two or three quarters, or you guys have had flat or negative comps now for six or seven quarters, is it something that you've really been seeing, sort of, longer term than that?

**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Well, we've talked about it before. You're right. We probably haven't put as much attention on it. It's certainly come to light more, over the last several quarters. And some of it's been pretty aggressive in the price drops, I mean even our wholesale costs in some of these products in the last year have come down pretty dramatically. And you can see that at retail. I mean, again, I'll use the DVD example. Two years ago, it was 199, or thereabouts, I'm throwing out numbers, and Christmas this last year, the high side was $49. And so as those have come down, albeit, it may have come down six or nine months ago, it takes -- I mean, all of those that we had on rent didn't just go away when the prices dropped.

**Shaumo Sadhukhan** - *Basswood Partners - Analyst*

Right.

**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Excuse me. What happens is the demand for them going forward slows, and then as you get time under your belt, it aggregates --

**Mitch Fadel** - *Rent-A-Center - President and COO*

As those have paid out and stuff -- consumers have taken ownership, they haven't been replaced.

**Mark Speese** - *Rent-A-Center - Chairman and CEO*

There you go.

**Mitch Fadel** - *Rent-A-Center - President and COO*

And, obviously, on the bigger products, we haven't replaced the smaller ones enough. The fact that they're flat or up a little bit, obviously, they haven't replaced it enough. And that's why we continue to look for additional products and services to replace that revenue stream.

**Shaumo Sadhukhan** - *Basswood Partners - Analyst*

Right. So let me ask you this. When I look at your business and I try to think about, sort of, the issues that you're facing, I guess there are four primary, potential ones, right? So one is problems with the low-end income consumer, in general, right? So, real income for low-income consumers in the last three or four years have not gone up, maybe have gone down a little bit. Second is gas prices. You've talked about that. The third is this lower-end electronics issue, deflation on the low end for some of these products. And the fourth might be something that the competition could be doing, so Aaron's or one of the other competitors, or the industry as a whole. I'm wondering if you could rank at this point in time how you rate those in terms of which ones are the major ones and how important they are?

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**Mitch Fadel** - *Rent-A-Center - President and COO*

I don't know -- rating them off the top of my head. I will say we believe that out of the four you just mentioned, we've been talking about the competition is number four out of those four, on the bottom. We say that, not just to be smug about we're better than the competition or anything like that, but we -- I mean, we have statistics. As we mentioned earlier, if there -- whether there's competition or not, our comps aren't varying very much. It's very slight. The price test, where we match some competitor pricing and did some things, didn't really matter. It's not as price sensitive as -- as you may think.

So the competition, we can look at stores in our computer where there's a competitor across the street, three miles away, how far away, and all that, and we've just cut the number so many different ways, that our problems are deeper than whether there's just a competitor across the street. Quite honestly, that would be the easy part. I mean, if you could just say it's -- when a competitor's across the street and you just have to drop prices and lose a little margin to grow your business, that would be a lot easier than -- or what we've seen now, where it doesn't matter whether -- certainly doesn't materially matter whether there's a competitor across the street or not. So we put that forth out of your list of four. And how you rate the other three, probably the combination of the, what's going on with the consumer and the gas prices, probably some combination of those two.

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**Shaumo Sadhukhan** - *Basswood Partners - Analyst*

You'd say that would be higher than this low-end electronics deflation issue? Or you would say the low-end electronics deflation issue is more important than -- if you want to combine the gas prices and the low-end consumer? So the issue is -- Is it the product issue on the lower-end electronics more important, or is it more just what's happening with your consumer's ability to spend money in your store?

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

I think they're both -- I think they're both important and you can put one ahead of the other. I don't know that it really matters, but they're both important.

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**Shaumo Sadhukhan** - *Basswood Partners - Analyst*

Okay. That's fair. That's fair. Last question is -- In terms of the unprofitable stores, is there any pattern -- ?

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**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Hello?

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**Operator**

Just one second, sir. We seem to be having technical difficulties. I'll open his line again, sir.

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**Shaumo Sadhukhan** - *Basswood Partners - Analyst*

Hi, guys. Do you hear me now?

**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Yes.

**Shaumo Sadhukhan** - *Basswood Partners - Analyst*

Okay. Sorry. Last question is -- In terms of the unprofitable stores, are there any sort of patterns in terms of when they were required, so how the old Thorn stores are doing versus Rainbow, which you acquired more recently, versus RentWay, which were lower-volume stores when you acquired them, in terms of the group that's unprofitable, is there any specific categories like that that might be doing better or worse?

**Mark Speese** - *Rent-A-Center - Chairman and CEO*

No, not really. In fact, the Rent -- just by way of example, the RentWay --

**Robert Davis** - *Rent-A-Center - CFO*

I think, I think -- this is Robert. I think the important thing that we've tried to draw out here today, and I mentioned in my prepared comments, that the average store in our comp is 6.5 years old, and certainly the older the stores get, the more mature they become and the less easy it is to move the needle from a comp perspective. By way of example, the RentWay stores that we acquired in February of '03, in this quarter, those stores were comping over 7.5%. So, obviously, the younger the stores are in our business model, the more positive impact they have from a comp perspective and so forth. And the older the stores are, be it the Thorn stores that we acquired in '98 or others previous to that, Renters Choice, and so forth, those stores are, by nature mature, and that's why we're focusing on other products and services to be able to leverage that real estate and that infrastructure.

**Mitch Fadel** - *Rent-A-Center - President and COO*

As far as those -- the losers, there's really no geographic pattern either.

**Mark Speese** - *Rent-A-Center - Chairman and CEO*

No.

**Mitch Fadel** - *Rent-A-Center - President and COO*

It's a matter of which city did we -- if we bought two stores and they had an -- another year left on their lease and, as Mark mentioned earlier, and we tried to have four stores in that city, but now maybe three is the right number just because the leases are run out, those kind of things, it's more a matter of a city-by-city basis.

**Shaumo Sadhukhan** - *Basswood Partners - Analyst*

Okay. Thanks, guys. I appreciate the help.

**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Thank you.

**Operator**

And that is all the time we for questions. Gentlemen, will there be any closing remarks ?

**David Carpenter** - *Rent-A-Center - VP of IR*

Yes.

**Mark Speese** - *Rent-A-Center - Chairman and CEO*

Well, again, thank you very much for your time and participation today. We do appreciate your support. Again, we realize we've got a lot of work to do. We are diligently addressing the issues. We're excited about the opportunities that lie ahead, particularly as we talk about some of these other services that we believe we can use to augment our store base. We do look forward to reporting back to you next quarter. And, as always, if you have follow-on questions, don't hesitate to call any of us. Thank you, very much.

**Operator**

This concludes today's Rent-A-Center conference call. You may now disconnect.