

FINAL TRANSCRIPT

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RCII - Q2 2006 Rent-A-Center Earnings Conference Call

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PRESENTATION

Operator

Welcome to Rent-A-Center's second quarter 2006 earnings release conference call. [OPERATOR INSTRUCTIONS] As reminder, this conference is being recorded Tuesday, July 25, 2006. Your speakers for today are Mr. Mark Speese, Chairman and Chief Executive Officer of Rent-A-Center; Mr. Mitch Fadel, President and Chief Operating Officer; and Mr. Robert Davis, Chief Financial Officer; and Mr. David Carpenter, Vice President of Investor Relations. I would now like to turn the call over to Mr. Carpenter. Please go ahead, sir.

David Carpenter - *Rent-A-Center - VP of Investor Relations*

Thank you, Kinesia.

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Good morning, everyone and thank you for joining us. You should have received a copy of the earnings release distributed after the market closed yesterday that outlines our operational and financial results that we made in the second quarter of 2006. For some reason you did not receive a copy of the release, you can download it from our web site 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 web site. 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 2005 in quarter report on form 10-Q for the quarter ended March 31st 2006 as filed with the S.E.C. Rent-A-Center undertakes no obligation to publicly update or revise any forward-looking guidance. I'd now like to turn the conference call over to Mitch. Mitch?

Mitch Fadel - Rent-A-Center - President, Chief Operating Officer

Thanks, Dave. Good morning everyone and thanks for joining us on our second quarter earnings call.

It was definitely a good quarter for us as we ended up with a 1.1% comp that was primarily related to being a little less promotional on our offerings as well as an increase in the number of units on rent. Our comp guidance for the third quarter is between 2.5% and 3.5% as you probably saw in the press release. Some of that expected comp is due to a more favorable calendar this year in the third quarter versus last year. What I mean by that, this year we have an extra Saturday in the third quarter whereas last year, we had an extra Friday. The difference in revenue for us on a Saturday versus a Friday translates to about 0.7 meaning that 0.7% of our comp in the coming quarter will be calendar-driven.

On the other hand, in the fourth quarter, the calendar works against us there as we have one less business day. And this affects us because we're closed on Sunday so you end up with different business days in a quarter over last year because of being closed on Sunday. And the lost business day compared to last year is the Saturday in the fourth quarter. Now when we lose a Saturday, that will hurt our comp guidance -- our comp in the fourth quarter by 2.5%. So, when you look at our annual comp guidance of 1 to 2, that's because today we're expecting a flat fourth quarter comp due to the calendar shift hurting us by the 2.5% I just talked about. So if you take the calendar shifts out of the equation, or basically normalize the same store sales, the third quarter estimate would be in the range of 1.8 to 2.8 before you add in the calendar help that takes us to 2.5 to 3.5. And the fourth quarter estimate would be 2 to 3 before you factor in the calendar hurting us 2.5.

So again, if you normalize the comp, if you look at our guidance right now, the third quarter is 2.5 to 3.5. You can tell by looking at the annual guidance of 1 to 2 that we project a flat comp in the fourth quarter but if you normalize based on the days, again, the third quarter being the 1.8 to 2.8 range and the fourth quarter would be in the 2 to 3 range. So, our business has turned around this year and we'll continue to be less promotional in the third quarter than we were last year which is helping to drive more revenue per delivery.

Our advertising changes that we made over the last 12 months are working well for us as we continue to tweak those. Our new home package that allows for discounts on larger rentals of three or more core products continues to be a success in getting additional business. In terms of new technology in our stores in addition to the 42 inch flat panel televisions that we've had in our store since early this year, in July, we've added 32 and 37 inch flat panels so we now have a full range of flat screen technology in our stores. And as we've talked about, before as pricing comes in line on smaller size panels like the 26 inch models, we'll be adding those as well and we see that as an opportunity to get back that small TV category that has evaporated on us over the last few years.

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On a collections front, we remain consistent as our second quarter weekly credit averages were lower than they've been the last few years for that quarter. And our quarterly loss rate on customer skips and stolen is a percent of revenue came in at a solid 2.2%. Our inventory levels remain consistent with our expectations as our idle or the idle inventory was at 22% our total inventory at quarter's end. This is up from the end of the first quarter as expected due to the seasonality of the business and the normal slower summer months. Much better than last year though and within what we would consider the normal range of 20% to 24%.

In addition to being focused on driving our top line, we're always looking to improve our expense controls. You may recall that we've talked about a new procurement program for operating supplies and fuel and so forth that started earlier this year. Pleased to tell you that program has now been rolled out to all of the United States stores. It not only makes it easier for our stores to get the operating supplies they need but we also believe it will save us money on the expense line going forward. So, all in all, a very fine quarter as we grew our top line while continuing to manage our collections and our inventory and our expenses in a very effective way. And I'd like to thank our 16,000 coworkers for all of their hard work in making the second quarter a success.

And with that, I'll turn it over to Robert for some specific financial updates.

Robert Davis - Rent-A-Center - Chief Financial Officer

Thanks, Mitch. I am going to just spend a few quick moments updating you on the income statement, balance sheet, and cash flow statement after which I'll turn the call over to Mark for some closing comments before we take questions and answers. I would like to reiterate that much of the information that I present whether it is historical results or forecasted results will be presented on a recurring and comparable basis.

Pertaining to the income statement as outlined in the press release, total revenues increased during the first quarter. Second quarter by 0.5% with blue earnings per share increasing 7.7% from the prior year to \$0.56 largely driven by positive same-store sales comp of 1.1%. EBITDA for the quarter increased 1.4% from the prior year to 89.7 million with the margin increasing 20 basis points to 15.4%. EBITDA margins have now increased for four consecutive quarters and we expect our third quarter EBITDA margin to be roughly 200 basis points greater than last year's third quarter. For the last 12 months ending June 30, 2006, pro forma EBITDA has totaled approximately \$325 million.

I would like to spend just a brief few seconds and touch on the positive developments on our self-insured property and casualty insurance fronts as mentioned in the press release. As many of you may recall, we have invested heavily in this area over the prior few years in order to better manage this cost line. As a result, we now have several years of history, seven to be exact, relating to Rent-A-Center specific losses within worker's comp, auto and general liability that are independent third party actuaries can now provide management with lost forecasts based upon our own certain specific loss history. Rather than general industry-related forecasts.

Management, having been provided this information from the independent actuaries, determined that lost forecast based upon certain of our own loss history is more indicative of our ultimate loss exposure and we accrued for these expenses accordingly. At this point, the reduction to our cumulative accrual balance in these areas of \$2 million, as mentioned in the press release, is indicative of the amount of success we have achieved thus far in managing this complicated risk area. Obviously we'll continue to manage this area with the same vigor we have to this point, with the hopes that we can further drive down costs in this area in the future.

Now, from a cash flow perspective, the company has generated nearly \$35 million in operating cash flow during the first six months of the year. This is down just over \$20 million when compared to the same period the prior year. This decrease is largely the result of an increase in working capital or inventory purchases of roughly \$50 million during the six month period ending June 30, 2006. As compared to a \$13 million increase for the same period the prior year, so a \$37 million swing. Timing differences on inventory purchases in a healthy, positive comp have led to these differences year over year, yet we continue to expect

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nearly \$200 million in operating cash flow for the entire year of 2006. While beginning the year with approximately \$58 million cash on hand, the company has since utilized approximately \$33 million in Cap Ex. Just over \$21 million in the acquisitions of stores and accounts and close to \$5 million in share repurchases. And have reduced outstanding indebtedness since the beginning of the year by roughly \$7 million, while ending the quarter with approximately \$41 million in cash-on-hand.

Now, at quarter end, our consolidated leverage ratio was down to approximately 2.1 times. Our interest coverage ratio increased to approximately 6.5 times and debt to book cap at quarter end equated to 43.9%. A reduction from 46.8% at year end. With outstanding indebtedness at just over 717 million as of June 30th and that indebtedness was comprised of the following components at the end of the quarter: 343 million in senior debt, 74.1 million on the revolver and line of credit with our revolver availability at quarter end of just over \$72 million. And again, the \$300 million or 7% subordinated notes.

Now while those balance sheet updates are where we ended the quarter as most of you know we just completed the refinancing of our senior credit facility, which was closed and funded during the second week of July in the third quarter. While the refinancing did not materially alter the complexion of our capital structure per se, we were able to increase our revolver capacity from \$250 million to \$400 million. As well as create additional flexibility within our covenant package and tighten the spreads in our borrowing 50 basis points on our leverage based pricing grid. We do expect to record a charge of approximately \$2.2 million during this current quarter, the third quarter to write off the unamortized financing fees from the prior senior credit facility.

Now since the end of the June quarter, we have further reduced our outstanding indebtedness by roughly 21 million, paying down some the outstanding revolver. And therefore, as of today, our current outstanding debt is as follows: we have 200 million outstanding under term loan A, 125 million outstanding under term loan B, 68 million drawn under our revolver and now our revolver availability is over \$222 million. The \$300 million of senior subordinated notes remains outstanding.

While consistently a strength of this company, we've now solidified our balance sheet even further providing us the liquidity and flexibility to manage and grow our business. Continue to invest for the long-term health of the organization and capitalize on short-term opportunities as well.

In terms of guidance for the third quarter of 2006, we anticipate total revenues to range between 584 million and 592 million and diluted earnings per share to be between \$0.46 and \$0.50, which excludes the impact of the write-off of our unamortized loan fees mentioned previously which will have a about a \$0.02 impact. For the fiscal year ending December 31st 2006, we are increasing guidance and now expect total revenues between 2.36 billion and 2.38 billion. With our same-store sales between a positive 1% and positive 2%.

Additionally, we're projecting 2006 EBITDA margins between 14% and 15%. Diluted earnings per share before the write-off of unamortized loan fees once again are estimated to be in the range of \$2.08 and \$2.15. And as always, our current guidance excludes any potential benefits associate with additional debt repayments, stock repurchases or acquisitions completed after the date of this press release. With that financial update, I'm going to turn the call over to Mark.

Mark Speese - Rent-A-Center - Chairman, Chief Executive Officer

Robert, thank you very much and good morning, everyone. As always, we appreciate your time and interest in joining us.

Just a couple of brief comments. As you heard from both Robert and Mitch, the business continues to improve and I am pleased with our overall results. I believe that some of the headwinds that we have been facing and have spoken of are beginning to subside.

One is our customers are becoming more acclimated with the higher energy cost and secondly that much of the product deflation issues on the lower-end consumer electronics have run their course as those products simply make up a smaller and smaller piece of our overall business.

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As Mitch mentioned, we are introducing more of the new technology and in various screen sizes and expect to continue adding those throughout the year. As he also mentioned, we believe that we have an opportunity to recapture some of that lost business in the future. I'm very pleased also with how the stores, our coworkers have executed our plan now over the last several quarters. And believe that again, we've got some positive momentum going in throughout the balance of the year. With the continuation of the store rationalization, you noticed a small reduction in the store count for the quarter and year-to-date.

However, we continue to expand. Having opened 9 new stores in the quarter and 19 year-to-date as well as acquiring 18 stores in the account buys of 20 others thus far this year. Of course we're continuing expansion of the financial services into the existing Rent-A-Centers, having added 21 for the quarter and 38 year-to-date giving us a total of 77. While I've mentioned previously that getting the necessary licensing is sometimes difficult and time consuming, we still expect to be able to add these services to an additional 60 or 70 stores yet this year. In addition, the results of those added thus far continue to perform in line with our overall expectations.

As a reminder, we expect revenue from financial services at maturity which is defined as 18 to 24 months old, of approximately \$15,000 to \$20,000 per month with an EBITDA margin of between 30% and 40% as we leverage our real estate and infrastructure. As also noted or mentioned, and as Robert alluded, given the current results and with the assumption that energy costs remain at the current levels, we are raising the forecast for the balance of the year to now be again between the \$2.08 and \$2.15 per share versus the previous guidance of \$2.00 to \$2.10.

Again, as Robert mentioned, the balance sheet and capital structure are healthy and along with the cash flow gives us the flexibility to continue executing our plans and growing the business. So, all in all, a very good quarter. I also appreciate the hard work and commitment of all of our coworkers as well as your support, as well. And with that, we'd be now happy to go ahead and open the call up for questions.

QUESTIONS AND ANSWERS

Operator

[OPERATOR INSTRUCTIONS] Your first question comes from Chris Horvers from Bear, Sterns.

Chris Horvers - *Bear, Sterns & Co. - Analyst*

Good morning, everybody and great quarter.

Mark Speese - *Rent-A-Center - Chairman, Chief Executive Officer*

Good morning, Chris. Thank you.

Chris Horvers - *Bear, Sterns & Co. - Analyst*

So, two questions. First, on the categories, the 1.1 comp at the high end of the range, can you talk about, within the mix, the furniture, the appliances versus the consumer electronics, what drove the comp and which categories are doing better?

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

I would say for the quarter, it was pretty even. We talked about -- there was no one category that jumped out in front of the others. We talked about the new technology coming in the stores. And the majority of that has just come in here in the first

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couple of weeks in July. We've had a 42 inch plasma in the line-up. We do have the newer projection TVs, the LCD projections and DLP and so forth. But those kind of projection TVs have replaced the old bigger projection TVs and the flat panel technology really is just starting in the stores with the 32 inch and 37 inch arriving in July and the 42 inch has done well since we've had it in the store earlier in the year but that one product, it is not like that lifted the whole comp or anything like that. So, I would say the answer, Chris is, pretty even through computers, electronics, appliance and furniture.

Chris Horvers - *Bear, Sterns & Co. - Analyst*

So as a category was consumer electronics positive in the second quarter?

Mark Speese - *Rent-A-Center - Chairman, Chief Executive Officer*

The category as a whole, probably not. And again, as Mitch alluded to, we're just getting in more and more this new technology. Certainly the appliances, the furniture and the computers continue to remain strong for us and we're starting to get back some of that consumer electronic, the big screen category has been strong but when you look at the other products, they're just now starting to come in and on a comparable basis, they're probably down slightly.

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

It is a little hard to answer that, Chris, because we look at our product categories for all of our stores but we don't actually take the comp in and the stores in the comp to 2300 or so that are in the comp and look at the comp stores in those categories. We kind of look at all of the stores. And like as Mark alluded to, we do expect to get some of the smaller TV back later in the year as we bring in smaller sizes. On those flat panels. When we bring in a 26 or a 23 inch TV, that is a category we've just lost now that those are more of a commodity item at retail and when we get flat panels in, in those sizes, we'll look -- we think that's an opportunity to get that back but it is not like the new technology is driving the comp in the second quarter.

Chris Horvers - *Bear, Sterns & Co. - Analyst*

Yep. So comps will get better basically. When do you expect the smaller screen sizes to come in? I know you have the 30 inch now.

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

We've got 32 and 37 and 42 now. And we're looking this fall to add at least a 26 and watching the pricing on that, the way it's dropping so fast. But I think we'll have them-- I'm pretty sure we'll have the 26 inch in October. Maybe the 23 but we're just watching the pricing on -- the deflation on those products. In this case, the deflation on those flat panel TVs is a good thing for us because they're deflating pretty fast. That's a good thing for us to bring them in. When a 26 inch TV, flat panel TV was \$1500, we couldn't bring it in and use it as a rental item but at \$700 or \$800 or \$600 wholesale is a whole different ball game for us.

Chris Horvers - *Bear, Sterns & Co. - Analyst*

Excellent, thank you. On the financial services, have you decided which model you would roll out and then you pulled back the number of stores you're going to add to this year. Are you now in the range down to the lower end, how should we think about '07? Do you think that would ramp once you work out the details?

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Mark Speese - *Rent-A-Center - Chairman, Chief Executive Officer*

Yeah. Your first question in terms of what platform-- what we call the "box in the box" or the "in-store" store, no firm decision has been made on that. We're continuing to open both of those as we speak. And really, at this point, neither one again is appearing to have a significant lift over the other. And again, there's other learning that we want to get out of it. Not just what they're doing from a revenue perspective but again as we look at being able to leverage customers between the two and where they started from originally and so forth. That takes time to get those data points.

In terms of the number, still within the range. You're right. It is more at the lower end and again a lot of that has been predicated, as I mentioned, the licensing which in some cases, in some states is taking quite a bit more time than we originally estimated. Outlook for next year has not changed at this point. I still believe that once we get this -- we're going to be able to ramp up about the 250 that we've spoken of. Been a little bit slower on the front end but I don't see that hampering our overall outlook at all.

Chris Horvers - *Bear, Sterns & Co. - Analyst*

Thank you very much.

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

Thanks, Chris.

Operator

Your next question comes from Arvind Bhatia from Sterne, Agee.

Arvind Bhatia - *Sterne, Agee & Leach, Inc. - Analyst*

That's Sterne, Agee. Thank you and congratulations guys. Great quarter.

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

Morning. Thanks Arvind.

Arvind Bhatia - *Sterne, Agee & Leach, Inc. - Analyst*

Just trying to break down the comp a little bit if I could. How much is the 1.1 as a result of traffic versus pricing? That's the first question. And second, any updates on the New Jersey lawsuit that you might have for us?

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

Well, the first one on traffic versus pricing, we don't -- disclose the difference in those or give specific numbers on what made up the comp but as we put in the press release, we have more units on rent as well as just pricing so it is coming from both places and when we say pricing, it is not a matter of raising our price as much, it is not giving as much away on the front end on the promotional side like we've been saying. It is a combination of the promotional side, giving away less on the front end on the trial offers and so forth and then the units on rent are up also so it's a combination of those two. As far as New Jersey, we continue to work through that case. We have made some changes in our model up there from a pricing standpoint and are

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comfortable with the changes we've made. We'll comply with the Supreme Court ruling and it is business as usual with a little different pricing model up there.

Mark Speese - *Rent-A-Center - Chairman, Chief Executive Officer*

In terms of the case itself, there are no new developments per se to report on at this time as you can imagine, that's going to take a fair amount of time to work through. Again, we-- our intentions are to look at the appeal process as it related to the original decision that the New Jersey Supreme Court made. And again as a reminder for everybody that case is specific to New Jersey only.

Arvind Bhatia - *Sterne, Agee & Leach, Inc. - Analyst*

On the -- I guess on the mix issue on the pricing, et cetera, as you move towards more of the plasmas, DLPs, et cetera, as a bigger percentage or fewer mix, historically, can you refresh us on what that means for your comps? As I recall at least it helps you -- 1% or so as you upgrade -- as you participate in the TV cycle, any comments on that front?

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

It can help certainly in the larger sizes from a pricing standpoint. A lot of these flat panel TVs, like a 42 inch plasma, is what the customer wants these days but maybe if they would have rented a 50 inch projection TV, there's not that much difference in the price. We certainly don't have factored in that 1% of our comp is going to be because of the higher prices there. There might absolute increase. But we certainly don't have anything that large factored into our comp.

Arvind Bhatia - *Sterne, Agee & Leach, Inc. - Analyst*

Got it.

Mark Speese - *Rent-A-Center - Chairman, Chief Executive Officer*

Yeah. Probably the other way of thinking about it. Again, I don't think any of us in a position to try to quantify it. If you think of what used to be a 25 inch tabletop portable that may have rented for \$14 a week and when and if we bring in this 26 inch flat panel, as an example and that may rent at -- and I don't know the amount but just for an example, may rent at \$19 a week. So, there's certainly some pricing increase potential there. Now, how many does that translate to and what's the demand? I'm not willing to go to that -- but I can give you that comparison but I can't tell you how many are going to go out and when we're going to bring it in. That kind of an opportunity is there. I think that's the point you're maybe trying to draw out.

Arvind Bhatia - *Sterne, Agee & Leach, Inc. - Analyst*

Right. But what you're saying is that's not factored into the numbers for the rest of the year at least.

Mark Speese - *Rent-A-Center - Chairman, Chief Executive Officer*

That's correct.

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Arvind Bhatia - *Sterne, Agee & Leach, Inc. - Analyst*

Ok. Any comments on the environment out there for acquisitions, small or large, have multiples remained about the same, kind of what's the demand and supply situation out there?

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

The second quarter, as you saw in the press release, was pretty active for us by in acquiring 16 stores as well as accounts from 15 other locations so 31 stores was probably one of the more active quarters over the last couple of years. And the multiples have stayed in-- from as low as 6 to probably as high as 10 but more in the range of 7 to 9. You'll get - you'll pick up an occasional store, maybe a one-store deal at 6 or 7 but the range is more like 7 and 9 and then it is the exception to be outside that range. So, there seems to be, as you know, they're all-- as compared to a few years ago, they're mostly smaller acquisitions now but again, the second quarter was pretty active with 31 stores and it is still a great use of our cash.

Arvind Bhatia - *Sterne, Agee & Leach, Inc. - Analyst*

Is that a function of you guys looking for more or you think you're getting more incoming calls because either it is getting harder for the mom and pops, just trying to get some color on-- is there anything more to it than just you finding an opportunity in a quarter.

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

We really haven't changed our method of going and notifying people that we're an active buyer in this industry and as more people said yes or have called us and pursued the sale earlier this year than maybe they had over the last couple of years. I don't really know why that would be. I don't think the number are that big to draw any of those conclusions with 31 stores that they're finding it harder to make it or anything like that. I really don't know what the reason for the pickup would be because we're operating the same way we have been and again, I don't think I would read too much in it being over 31 stores. It is better than what we've been doing but it's not like it was 100 stores either.

Arvind Bhatia - *Sterne, Agee & Leach, Inc. - Analyst*

Final question, I guess. On the ColorTyme side of your business, how is that doing just from a trend standpoint? Are they also experiencing similar trends that you are? Are you seeing opportunities to pick up stores there? Or not?

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

They're at about 300 stores, 292, I guess. And this year, we've picked up a few of their stores and they're growing. They'll probably add 30 or 40 stores this year. Their overall store count might not change -- won't change by that much because we do end up picking up some of their stores when the franchisees want to retire. We're their exit strategy when they want to cash out. Just like the last couple of years where they've opened 40 or 50 and we've coincidentally ended up buying about that many and they stay around the 300 store base but there's a lot of growth there, there's a lot of new stores open. Even though you don't see it when you just look at their overall count. They're doing pretty well.

Arvind Bhatia - *Sterne, Agee & Leach, Inc. - Analyst*

Great. Once again, congratulations.

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Mitch Fadel - Rent-A-Center - President, Chief Operating Officer

Thank you, Arvind.

Operator

The next question comes from Dennis Telzrow from Stephens Incorporated.

Dennis Telzrow - Stephens, Inc. - Analyst

Good morning, gentlemen.

Mark Speese - Rent-A-Center - Chairman, Chief Executive Officer

Good morning.

Dennis Telzrow - Stephens, Inc. - Analyst

Robert, I missed this but on the Q3 guidance of \$0.46 to \$0.50, did that exclude the \$0.02 from the refinancing?

Robert Davis - Rent-A-Center - Chief Financial Officer

That's correct. It is before the write-off of the unamortized loan fees. Kind of a recurring run rate, if will you.

Dennis Telzrow - Stephens, Inc. - Analyst

Sure. Second question, with regard to the payday stores, have you entered any new states that ColorTyme acquisition made where not in the first six months year-to-date?

Mark Speese - Rent-A-Center - Chairman, Chief Executive Officer

Yeah, Colorado is one example. That they did not have operations in that we have since just recently, Nevada, I guess would have been another. Arizona. So, we're starting to expand out of those original states that the 27 stores that we bought into, if you will, a year ago. Yes. And we're looking further east as we speak. And kind of gets back to that issue, the comment about the licensing and so forth. We've applied for licenses in several new states further east from those that I just mentioned.

Dennis Telzrow - Stephens, Inc. - Analyst

When you go into those states, enough critical mass you get advertising?

Mark Speese - Rent-A-Center - Chairman, Chief Executive Officer

Yes. We're again only focusing on states that have favorable payday legislation. And where we have mass and then identifying stores within those areas that fit the profile as we've set it up now in terms of the demographics of that neighborhood and our boxed in which we can operate in but yes, not just advertising synergies, if you will, but also being able to-- as we think about leveraging middle management and so forth, where they've got critical mass within a defined area, also.

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Dennis Telzrow - *Stephens, Inc. - Analyst*

Ok. Thank you very much.

Mark Speese - *Rent-A-Center - Chairman, Chief Executive Officer*

Thanks, Dennis.

Operator

Our next question comes from Henry Coffey from Ferris, Baker, Watts

Henry Coffey - *Ferris, Baker, Watts, Inc. - Analyst*

Good morning. Let me join the long list of people congratulating you.

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

Thank you. Good morning, Henry.

Henry Coffey - *Ferris, Baker, Watts, Inc. - Analyst*

A couple of questions first and I apologize for this, the analysis of the same-store sales and the calendar was very helpful but I didn't catch all the details can we run through that real briefly again? In terms of how days affect?

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

Yep. Sure. Again, you know, the calendar shift, Henry, with us has a lot to do with not being open on Sunday otherwise the quarter would have the exact same number of days in it.

Mark Speese - *Rent-A-Center - Chairman, Chief Executive Officer*

And the fact that customers pay weekly and they pay on the weekend and --

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

Right, Right. If the calendar shift was a Wednesday replacing a Tuesday or something, we wouldn't even need to talk about it. With the third quarter being a Saturday versus last year, the extra day, when I say the extra day, over 13 full weeks, I guess you call it the 92nd day of the quarter, it is a Saturday versus a Friday. So, that's helping us .7 in the third quarter.

Mark Speese - *Rent-A-Center - Chairman, Chief Executive Officer*

What that means is we do a lot more revenue on a Saturday than on a Friday.

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Henry Coffey - Ferris, Baker, Watts, Inc. - Analyst

Right.

Mitch Fadel - Rent-A-Center - President, Chief Operating Officer

In the fourth quarter because the extra day in the quarter is a Sunday, there's 14 Sundays in the fourth quarter, we lose a whole Saturday compared to last year in the fourth quarter.

Henry Coffey - Ferris, Baker, Watts, Inc. - Analyst

Right.

Mitch Fadel - Rent-A-Center - President, Chief Operating Officer

And that's a 2.5% effect by losing that whole Saturday in the fourth quarter.

Henry Coffey - Ferris, Baker, Watts, Inc. - Analyst

Right.

Mitch Fadel - Rent-A-Center - President, Chief Operating Officer

So, our guidance right now for the third quarter is 2.5 to 3.5, .7 is being helped by the calendar shift. The fourth quarter our guidance is flat because-- you can back into a flat guidance when you look at the annual comp. And that's because of that 2.5% effect. If you normalize them, you might say the third quarter was 1.8 to 2.8 or the expected expectation is 1.8 to 2.8 and the fourth quarter is 2 to 3 if you normalize and get rid of those days.

Robert Davis - Rent-A-Center - Chief Financial Officer

What we're trying to draw out here, Henry, is we had a 1.1% comp in the second quarter. Normalized 1.8 to 2.8 in the third. Normalized 2 to 3 in the fourth. It is not as though the comps are going down after the third quarter when you normalize it given the calendar shift. We're trying to draw that out.

Mitch Fadel - Rent-A-Center - President, Chief Operating Officer

We knew when we put in guidance of 2.5 to 3.5 in the third quarter but then the year being one to two -- we didn't want people to expect to go back to a flat comp.

Henry Coffey - Ferris, Baker, Watts, Inc. - Analyst

We had a rocket ship ready to go and we had to slow it all down to like 4,000 miles an hour.

Mitch Fadel - Rent-A-Center - President, Chief Operating Officer

That's why we wanted to draw that out.

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Henry Coffey - Ferris, Baker, Watts, Inc. - Analyst

No, I appreciate that.

David Carpenter - Rent-A-Center - VP of Investor Relations

The summary, Henry, the summary of that statistical information that was given is on our website for those of you that did miss it, we do have it on the website.

Henry Coffey - Ferris, Baker, Watts, Inc. - Analyst

The second issue from reading between the lines here is flat screen TVs are just being rolled out and have really not worked their way into the numbers yet.

Mitch Fadel - Rent-A-Center - President, Chief Operating Officer

Correct.

Henry Coffey - Ferris, Baker, Watts, Inc. - Analyst

And then finally --

Mitch Fadel - Rent-A-Center - President, Chief Operating Officer

Screen sizes. Now we've added the 42 inch plasma--

Henry Coffey - Ferris, Baker, Watts, Inc. - Analyst

Finally, the first thing, you've given some store opening guidance but with all of the moving parts, it is difficult to translate into net new-store growth. Are we going to see shrinkage, expansion? If we look on just a net basis, where do you think we'll be year over year in '06?

Mark Speese - Rent-A-Center - Chairman, Chief Executive Officer

We'll probably be down because we had the significant store rationalization or consolidation in the third quarter.

Henry Coffey - Ferris, Baker, Watts, Inc. - Analyst

I mean December to December.

Mark Speese - Rent-A-Center - Chairman, Chief Executive Officer

With the projected growth going forward, you have that timeline sheet?

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Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

The third and fourth quarter will be positive. The first and second quarter --

Henry Coffey - *Ferris, Baker, Watts, Inc. - Analyst*

--were down. About a modest improvement. But you're still shuffling around good stores and bad stores.

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

I think the number will be slightly up from where it is today from the 2,749 [inaudible] That will be up at the end of the year.

Robert Davis - *Rent-A-Center - Chief Financial Officer*

Where we ended the year last year, we'll be up you know, a dozen stores or so by the end of the year this year.

Henry Coffey - *Ferris, Baker, Watts, Inc. - Analyst*

Great. Thank you very much. Again, good quarter. Excited to see you raise guidance the way you have.

Mark Speese - *Rent-A-Center - Chairman, Chief Executive Officer*

Thanks, Henry.

Operator

Your next question comes from Deforest Hinman from Paradigm Capital.

Mark Speese - *Rent-A-Center - Chairman, Chief Executive Officer*

Good morning.

Deforest Hinman - *Paradigm Capital - Analyst*

Hi, guys, sorry. Can you comment on Xboxs being in the store, how those done?

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

I don't have specific numbers in front of me. They have done well. And the games always do pretty well for us. We've had -- the PS2s in the past, the Playstations, the PS2s and we also have the portable games. The PSP I think it is called. Sony has the PSP, the portable games. We do pretty well in the game category. I wouldn't say that we've gotten any lift in that category. The Xbox is the most popular one now but with last year, PS2s and so forth. The Xbox has done well. I wouldn't say that's any part of the conflict.

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Deforest Hinman - *Paradigm Capital - Analyst*

All right. In the past we talked about the normal seasonality of the third quarter is down from the second quarter numbers and our revenue guidance at the low end is higher than the second quarter result. So, is that confidence coming from strength of the flat panels in the third quarter or is that just the overall rentals are better in all of the categories. What are our thoughts on that?

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

I think the second quarter this year from having units on rent was better than last year and when we talk about the seasonably being the slowest quarter, it is a quarter where we don't add very many new customers. It is not that the base business necessarily deteriorates. It is the hardest quarter to maintain the base business or add to the base business but mainly in the third quarter also, you've got the extra Saturday. Now, I talked about third quarter this year over last year there is an extra Saturday versus last year an extra Friday. But when we look at sequentially, the third quarter to the second quarter, there is an extra Saturday in the third quarter versus no extra days in the second quarter. 13 even weeks in the second quarter and in the third quarter, it is 13 weeks plus a Saturday so that lift would be coming -- we would still see it as seasonably the toughest quarter to grow our business. That lift-- a little bit is coming from the fact the second quarter our units are renting better than last year but probably even more so because of the difference in the calendar.

Deforest Hinman - *Paradigm Capital - Analyst*

All right. And in terms of the share repurchase activity, it is kind of I guess slowed. We still have around 39 million left on the allocation. Is it reasonable to think we would have that used up by the end of the year?

Mark Speese - *Rent-A-Center - Chairman, Chief Executive Officer*

Well, I can't say with certainty. We've always taken the position and stated that we use our free cash first to invest in the business. There was a lot of investment in the second quarter. Whether that was working capital for inventory to support the growth, some of the acquisitions, obviously that we did. But again, we've commented that we have an active share repurchase plan and in our case think that past behavior is probably indicative of the future views. So, as we generate free cash flow, again, first and foremost, support the growth of the business. But then we'll look at share repurchase and other opportunities and so forth. So, our outlook hasn't changed in the general overall sense.

Deforest Hinman - *Paradigm Capital - Analyst*

Thanks a lot, guys.

Mark Speese - *Rent-A-Center - Chairman, Chief Executive Officer*

Thank you.

Operator

Your next question comes from John Baugh from Stifel Nicolaus.

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John Baugh - *Stifel Nicolaus - Analyst*

Good morning, congratulations.

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

Thank you.

John Baugh - *Stifel Nicolaus - Analyst*

You probably won't want to comment on this but I would be interested, as it pertains to RentWay, which of course has been in the rumor mill, I guess. How did your experience go with the 300 odd stores you bought a few years ago and how would the rest of the chain, the 700 odd stores that are out there, differ from that and I'm sure you don't want to comment specifically about what you are or aren't doing but I would love some kind of gut feel as to what your interest level would be if that situation were to arise and whether there might be any antitrust concerns on your part.

Mark Speese - *Rent-A-Center - Chairman, Chief Executive Officer*

Well, you're right, John. We're not going to sit here and never have and I'm not going to comment on market rumors or speculation about any acquisition. As it relates to the stores that we bought a few years ago, those, as a whole, have performed pretty well in line with our expectation. About 2/3 were consolidated into existing Rent-A-Centers. A third or so were left open. Albeit we haven't spoken specifically about those for some time. I know the first year or two, we were breaking them out from a comp perspective. They were performing quite well. As far as they or anyone else you got to look at each one when and if it presents itself, who knows.

John Baugh - *Stifel Nicolaus - Analyst*

How would the remaining stores-- I assume the monthly rent on the remaining chain is higher than the stores you bought. Would that be correct?

Mark Speese - *Rent-A-Center - Chairman, Chief Executive Officer*

I think so.

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

Certainly the stores we bought in 2003 were their troubled stores and they're selling off the unprofitable ones. That's why 2/3 of them got merged in our stores because they were lower revenue stores. So, when you look at our average revenue and their public documents to-date, these would be a high revenue base.

John Baugh - *Stifel Nicolaus - Analyst*

Ok. Secondly, was there any regional flavor to the business in the second quarter? Pockets of strength or weakness?

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Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

Small differences but we look at that all the time really -- I do, anyhow, just to look at management in different areas. There's some small differences but nothing that pops up to say one part of the country versus another. You'll have a town where a factory might have closed that's struggling but you might have that town in California as well as the rust belt in Pennsylvania or in a Michigan or something. So, it is not so much a whole region or anything, more of a town by town thing. I would say in general, it is pretty even.

John Baugh - *Stifel Nicolaus - Analyst*

Ok. Lastly, on the New Jersey situation, I assume there's really nothing on an accounting basis you can do in terms of accruing, is that correct? Have you done anything or do you anticipate having to do anything?

Robert Davis - *Rent-A-Center - Chief Financial Officer*

We have not done anything to this point other than just certain legal costs in terms of settlement dollars there used to be some certainty around probability and estimated ability and we haven't reached that point yet. So, therefore, nothing has been accrued in that regard to this point.

John Baugh - *Stifel Nicolaus - Analyst*

Ok. Great. Thanks. Good luck.

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

Thanks, John.

Operator

Your next question comes from Alan Rifkin from Lehman Brothers.

Alan Rifkin - *Lehman Brothers - Analyst*

Mark or Mitch, with respect to the financial services model, can you maybe provide some commentary on what type of crossover traffic you're seeing between that and the core business? And what the conversion rates are in terms of trying to convert additional customers to the financial services model?

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

As new we are in the business, Alan, we've got our analysts keyed up to look at that stuff. When you look at that stuff, you want to say somebody was a financial services customer first and then renter or vis versa and how long did they stay on rent and so forth, so. Really that analysis is something that's going to take more months of operation than we've got under our belt so far. We're going to look at that stuff. And like I've said, we've got them already started looking at it. We don't have any real data yet. It's going to take longer than--

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Mark Speese - *Rent-A-Center - Chairman, Chief Executive Officer*

And to look at those result within the first couple of months of a store being open may give you the wrong impression.

Robert Davis - *Rent-A-Center - Chief Financial Officer*

Under our business model, it is not a retail transaction. Part of the viability of the business is how long does a customer stay on rent, what are they renting? To get a snapshot in the first few months to say that someone's rented a big screen TV, well, how long have they kept it? It will take a little bit longer for us to get that analysis.

Alan Rifkin - *Lehman Brothers - Analyst*

Fair enough. Are you trying to alter the marketing messages within the store to try to induce some of your core customers to use the financial services? Can you give us an update there?

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

We're certainly leveraging our marketing where we use a four page color flier-- part of-- almost the whole page, I guess, maybe the back, about half of the back page tells our customers about financial services and then conversely, the four page flier we send out for the financial services side has one whole page about other products we rent. We're just leveraging our marketing real estate, if will you, to send the message out there on the vehicles. When you go into a store, especially if it is in the front, you can't miss it. There is signage in the back. In a store busy, you can't miss the fact we're doing it but we're including advertising materials outside the store to try to drive traffic into both places.

Alan Rifkin - *Lehman Brothers - Analyst*

Ok. Thank you very much.

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

Thanks, Alan.

Operator

Your next question comes from Susan Jansen from Lehman Brothers.

Susan Jansen - *Lehman Brothers - Analyst*

Good morning. A couple of questions, if I might. First of all, as you look historically, are units on rent per customer about average or how has this been trending over time and then what is the average size of contracts? Have they been coming down, staying flat or going up and I'm thinking about over the past few years.

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

They've probably gone up slightly as when we added this home package opportunity for people when they rent three or more items to get a discounted rate it ends up building a pretty big rental rate relative to if they rented one item, obviously. I don't

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have the exact numbers in front of me, Susan. They've trended up a little bit. Not real significantly but they've trended up a little bit.

Susan Jansen - *Lehman Brothers - Analyst*

Ok. And then could you also tell me what is the limit in your bond indentures and your share buyback right now?

Robert Davis - *Rent-A-Center - Chief Financial Officer*

Right now, it is around 140 million, Susan.

Susan Jansen - *Lehman Brothers - Analyst*

Perfect. Thanks so much.

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

Thanks.

Operator

Your next question comes from Justin Boisseau from Gates Capital Management.

Jeff Gates - *Gates Capital - Analyst*

Hi. It is actually Jeff Gates. I have a couple of questions. First, would you say that your increase in comps and your confidence going forward is more a function of your existing customer base doing better or are you seeing a significant amount of new customers moving down into the rental market?

Mark Speese - *Rent-A-Center - Chairman, Chief Executive Officer*

Well, we're see a little bit of an increase in the traffic. The number of customers, if you will, foot traffic and so forth. Now, is that the new customers at the higher end falling in and/or a combination of maybe those that exited at some time in the past for a multiple of reasons now stabilizing and coming back in. I don't think any of us can sit here and quantify specifically oh, yeah, we're seeing an influx of more at the higher end coming in as access to credit becomes more difficult or as they face cost barriers and so forth but it is fair to say that we're seeing an increase in foot traffic and consequently the number of units on rent. Obviously Mitch alluded to our credit delinquencies and losses have been strong on a relative basis. Again, there is a little bit of seasonality there. But I think he allude that second quarter delinquency and losses were the best they've been in a period, quiet awhile, couple of years.

Jeff Gates - *Gates Capital - Analyst*

What was the average weekly ending past due percentage at the end of -- for the June quarter and for the -- and what was the '05 quarter?

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Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

We didn't give the numbers. All I said -- is it Jeff?

Jeff Gates - *Gates Capital - Analyst*

Yeah.

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

All I said was it's been very consistent. It was better than the last few years. I don't have those in front of me. It was in the low 6s, which is good for that time of year. You probably know our goal is to close out at 5.9% on a weekly basis. And that's customers that are one day or more past due. We count on Saturday night and summertime gets a little tougher so I end up in the low to mid 6s. That's about where we were in the second quarter. Again, it was better than we've done the last couple of years in the second quarter on average.

Mark Speese - *Rent-A-Center - Chairman, Chief Executive Officer*

The losses were 2.2% for the quarter which is very healthy, if you will.

Jeff Gates - *Gates Capital - Analyst*

Right. My last question is as far as what's driving the inventories are higher and I guess the good thing about that is it looks like the held-for-rent is down year-over-year. The amount on rental is up. I'm wondering what categories and components are driving that.

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

It is pretty much across the board. In both categories, the on-rent and the help-for-rent. The help-for-rent is not necessarily that we have less inventory in the stores although we're in -- we have -- we're doing better from an inventory standpoint this summer than we did last year but a lot of that is just with the store consolidation plan, there's less stores and there's more's on rent. It is not that we've changed our model a whole lot from not having enough inventory in the stores or anything but it's a little tighter than it was last summer then the consolidation plan is driving a lot of it.

Jeff Gates - *Gates Capital - Analyst*

Is the average unit out on rent a higher cost? Significantly higher cost than it was say --

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

Yeah, slightly higher. That's driving some of it as well.

Mark Speese - *Rent-A-Center - Chairman, Chief Executive Officer*

That just speaks to again the introduction of new technology. You know, replacing the low rent electronics that we may have had a wholesale of \$300. Now you've got a wholesale of \$450.

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Jeff Gates - *Gates Capital - Analyst*

Ok. Thank you.

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

Thank you.

Operator

Your next question comes from Henry Coffey from Ferris, Baker, Watts.

Henry Coffey - *Ferris, Baker, Watts, Inc. - Analyst*

Just to follow on, on the whole Rent-A-Center/RentWay discussion. Obviously you can't comment but, can you give me some specifics when you're looking at a large acquisition what are the pricing metrics that guide you? How important is near-term earnings dilution to your decision and how do you overcome any dilution related with a deal? Is it usually stock and cash or usually just cash? Just kind of a generalized view of how you would look at a large deal. I'll just get off the call and listen.

Mark Speese - *Rent-A-Center - Chairman, Chief Executive Officer*

Yeah. In my mind, the large deal could be 20 stores and you know, it depends, think back to Rainbow or Rent Rite--

Henry Coffey - *Ferris, Baker, Watts, Inc. - Analyst*

-- that was a really, really, really large deal.

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

The largest deal we did was ThornAmericas when we bought Rent-A-Center.

Henry Coffey - *Ferris, Baker, Watts, Inc. - Analyst*

Right, but I mean 300 or 400 stores, something that's going to be really impactful. How do you think through that?

Mark Speese - *Rent-A-Center - Chairman, Chief Executive Officer*

There's no one answer, Henry. No two deals are alike. I don't care if it is 1 store or 1,000 stores. You have to look at them as a stand-alone. What's the revenue and what's the synergies? Where is it aligned with your other stores? There's just -- there's no one answer.

Henry Coffey - *Ferris, Baker, Watts, Inc. - Analyst*

Is there an EPS dilution or return on invested capital guideline that factors in?

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Mark Speese - *Rent-A-Center - Chairman, Chief Executive Officer*

You look at all of that stuff. No one stands on its own.

Henry Coffey - *Ferris, Baker, Watts, Inc. - Analyst*

Thank you. Great quarter and the market seems to love what you're doing.

Mitch Fadel - *Rent-A-Center - President, Chief Operating Officer*

Thank you.

David Carpenter - *Rent-A-Center - VP of Investor Relations*

Thanks, Henry.

Operator

There are no further questions at this time.

Mark Speese - *Rent-A-Center - Chairman, Chief Executive Officer*

Ladies and gentlemen, thank you very much. As always, we appreciate your interest and support in the company. Again, I thank all of our coworkers for their hard work and execution against the plan. And obviously we look forward to reporting back to you next quarter with what we believe will be again some continued strong results and improved results. Thank you very much.

Operator

This concludes today's teleconference, you may now disconnect.

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