

FINAL TRANSCRIPT

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RCII - Q4 2006 Rent-A-Center Earnings Conference Call

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PRESENTATION

Operator

Good morning. Welcome to Rent-A-Center's first quarter 2006 earnings release conference call. As a reminder this conference is being recorded Tuesday, February 6, 2007. Your speakers today are 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 of Investor Relations.

I will now turn the conference over to Mr. Carpenter. Sir, you may begin.

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

Thank you, Tiffany. 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 were made in the fourth quarter as well as the full year for 2006. If for some reason did you not receive a copy of the release you can download it from our Web site at investor.Rent-A-Center.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 nonGAAP financial measures, the reconciliation of EBITDA is provided in our earnings press release under the statement of earnings highlights. Finally I must remind that you some of the statements made on this call such as forecasts, growth in revenues,

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earnings, operating margins, cash flow and profitability and other business or trend information are forward-looking statements. These matter are of course subjects to many factors that could cause actual results to differ materially from our expectations reflected in the forward-looking statements. These factor are described in our most recent annual report on Form 10-K for the year ended December 31, 2005, and our quarterly report on Form 10-Q for the quarters ended March 31, 2006, June 30, 2006, and September 30, 2006 as filed with the SEC. Rent-A-Center undertakes no obligation to publicly update or revise any forward-looking statements. I would like to now turn the call over to Mitch. Mitch?

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

Thanks, Dave. Good morning everyone and I would like to add my thanks for taking the time to join our fourth quarter earnings call. My comments will focus on our operating results for the quarter and year, and Mark will address the Perez charge a little bit later in the call.

So let's start with store operations. The fourth quarter turned out to be a very good one for us as we hit the high-end of our guidance with same store sales for the quarter coming in at 1%. Additionally we ended 2006 with a positive same store sales number of 1.9% for the year. The same store sales increases were primarily driven by having more units on rent, an indication that demand for our products and services is good. We believe that demands is being helped by a number of factors including the impact of advertising changes that we have made over the liver last year or so, the inclusion of home packages in our lineup, our competitive price match program as well as the new flat panel electronics technology just to name a few. On the collections front we remain very consistent with our prior performance. In fact in the fourth quarter our average delinquency numbers were lower than in 2005 as were our full year 2006 numbers. Our loss rate on customer skips and stolens as a percent of revenue was again consistent with past years and in fact slightly lower than in 2005. We remain a very effective and consistent collections operation.

Our inventory levels remain consistent with our expectations our as idle or held for in store inventory was 22.8% of our inventory at year end. This is down 60 basis points from the end of the third quarter and up over Q4 of '05 by 130 basis points which was expected due to the RentWay acquisition. Now speaking of RentWay as you know we closed that acquisition of 782 stores in the middle of November. We moved very quickly on the assimilation of that organization into ours and it's gone quite well. All key back office functions are now operating out of our Plano office and we are winding down what remains. There is a staff of only about 20 left in the Erie, Pennsylvania office and the majority of them will remain only for another month or too. As a reminder, of the 782 stores we acquired 145 or so were initially slated to be consolidate into an existing Rent-A-Center store and that's been completed. With regard to the remaining 640 or so, all have been converted to our IT systems, the realign many of personnel is complete and the name change campaign is taking place as we speak. Now, Robert will be talking more about the financial end of that acquisition but from an operations standpoint the integration has gone very well and I believe we are well positioned to execute the operational objectives.

In summary our core business is in fine shape. The integration and implementation of our business model into Rent-Way has gone quite well and we will continue to focus on execution in both our core stores as well as the newly acquired stores in 2007. I would like to personally and publicly thank all of our 20,000 co-workers on a very good quarter operationally, especially when you consider the work involved in the very well done assimilation of the Rent-Way stores and operation. Great job, everyone, and I thank you. And now with that I will turn it over to Robert for the financial update.

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

Thank you, Mitch. I am going to spend just a few quick moments updating you on our income statement and our balance sheet and our cash flow statement after which I will turn the call over to Mark for concluding comments before we go to Q&A. As always I would like to reiterate that much of the information that I present, whether it's historical results or forecast results will be presented on a recurring and comparable basis, which will exclude the matters that we discussed in the press release issued after the market closed last evening.

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As it pertains to the income statement, again as outlined in the press release, total revenues increased during the fourth quarter by 12.5%. Adjusted net earnings and adjusted diluted earnings per share increased 6% and 4.2% respectively from the prior year. And our adjusted diluted earnings per share of \$0.50 was at the top end of our guidance range of \$0.46 to \$0.50. As mentioned this was primarily driven by the positive same store sales comp of 1% that Mitch spoke of. Furthermore we do estimate that Rent-Way had a negligible impact to our fourth quarter results, as their positive contribution to operating profit was offset by duplicate G&A expenses as well as the incremental interest expense incurred. Adjusted EBITDA for the quarter increased over \$17.5 million from the prior year, or about 22.5%, to \$95.3 million. While the margin increased over 120 basis points to 14.5%. Now for the last twelve-month period ending 12/31, adjusted EBITDA has totaled approximately \$356.6 million, and our adjusted EBITDA margin for the full year of 2006 was 14.6%, a 60 basis point improvement over 2005.

From a cash flow perspective the company has generated nearly \$172 million operating cash flow during 2006. And walking through the cash flow statement if you will we began the year with \$58 million in cash on hand and the company has since invested over \$86 million in working capital, inventory purchases, utilized approximately \$84 million in CapEx, \$643 million in the acquisitions of stores and accounts, close to \$5 million in share repurchases and have increased our outstanding indebtedness as of 12/31, by over \$569 million, again primarily due to the increase in our term loan B facility of \$600 million during the fourth quarter related to the acquisition of Rent-Way. While ending the year with approximately \$92 million in cash on hand. At the year end our consolidated leverage ratio was roughly three times as we were able to add back some pro forma EBITDA from the Rent-Way for the last twelve-month period. Interest coverage ratio remains very healthy at approximately six times. Net to book cap at quarter end equated just over 58%, with outstanding indebtedness close to \$1.3 billion at 12/31.

Our debt levels at the end of the year broke out as follows. About \$918 million in senior debt [sic - see press release], \$75 million in revolver and lines of credit, with our revolver availability at 12/31 at approximately \$227 million. And of course, the \$300 million of 7.5% subordinated notes remain outstanding. Additionally, we have reduced our outstanding indebtedness by approximately \$30 million, primarily through repayments within the revolver and our line of credit. As a result, our current revolver in liquidity or capacity stands at around \$247 million. As always we continue to believe that the cash flow characteristics of our Company remains a core strength, and do not feel that the increased leverage brought on by the acquisition of Rent-Way will significantly burden our operational initiatives or continued growth expectations. But having said that, we will have to deliver our balance sheet in the near term and hope to be back around the two times leverage ratio as we were prior to the acquisition, within the next 18 to 24 months. Both by decreasing our outstanding indebtedness and continuing to grow our EBITDA with the addition of the Rent-Way locations as well as leveraging our core business, through continued positive same store sales results. That's not to suggest however that opportunistic share repurchase is out of the question as we will as always look to deploy our capital in what we believe to be the most effective manner.

In terms of guidance which now includes the anticipated contribution from the Rent-Way acquisition, but currently excludes any potential benefits associated with future stock repurchases to the extent there are any, or acquisitions completed after the day of this press release we now expect for the first quarter of 2007 for total revenues to range between \$749 million and \$764 million, and diluted earnings per share to be between \$0.62 and \$0.68. For all of fiscal 2007 we expect total revenues to range between \$2.935 billion, and \$2.985 billion, with our same store sales between a positive 1% and 2%. We we currently anticipate EBITDA for 2007 of approximately \$430 million. And the margins similar to 2006 or around 14.5%. Diluted earning per share are estimated to be in the range of \$2.24 and \$2.32. However as previously mentioned we do believe that Rent-Way will add about \$0.01 to \$0.02 to diluted earnings per share in 2007.

And a little insight here, given the seasonal nature of our business and success thus far in the assimilation process that Mitch spoke of, we would expect some slight uplift from the first quarter from RentWay due to higher pay outs during tax season. But we do and will expect that to flatten out in the second quarter. And then given the impact of the typical summer slow down and softer season during the third quarter, coupled with the lost revenue within the merged stores from RentWay earlier in the year we do expect some dilution in the third quarter. That will be offset by a positive and accretive fourth quarter from the RentWay locations, still believing that we will realize approximately \$0.20 cents in accretion in 2008. We still continue to believe that we are on track to realize approximately \$25 million in annual synergies resulting from the acquisition, comprised largely of general and administrative expenses, advertising costs and merchandise purchasing. The latter of which of course is realized

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over a couple of years as the acquired inventory of RentWay cycles through the system. With that update I would now like to turn the call over to Mark.

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

Robert, thank you very much and good morning, everyone. As always we appreciate your time and interest in joining us. Well, suffice it to say I'm very pleased with our overall operating performance and the improvements we continue to make in the core business as evidenced by the strong operating results as just reported. As Mitch mentioned, the demand remains strong and the operation team continues to execute the initiatives we put in place. I'm also very pleased with the progress we've made to date with regard to the integration of RentWay. As you heard from both Mitch and Robert, the integration is essentially complete, with all stores converted to our IT systems, the management realignment in place, most of the consolidations completed, the name change in progress and so forth. Now while I feel very good with where we are at this stage, the fact is we are early in the process, having only operated these stores for two months and having only one monthly financial report. I do believe we are well-positioned to realize the benefits that we have spoken of, but again we are early in the process and obviously still have plenty of work to do.

On the financial services front, things continue to move forward there as well. As noted we added 50 additional locations in the fourth quarter ending the year with 150 stores now offering these services. Given the large ramp up in the fourth quarter, coupled with the RentWay closing and the seasonality in that business, I say seasonality, demand is typically weakest this time of year as those customers have additional resources due attorney come tax refunds. We decide to do take January and part of February off, if you will, to strengthen our bench and to fine-tune our practices to prepare for the ramp up throughout the balance of the year. Now we do expect to open approximately 40 additional locations this quarter and still anticipate adding between 200 and 250 locations for the year. With regards to the format, it does appear as though the in-store model is performing slightly better than the box in the box, beating the number of loans, the revenues they're generating, the delinquencies and so forth. And while a final determination has not yet been made we are leaning that way and we will continue to monitor and evaluate the results for another quarter or two and then make final decisions going forward. All in all I'm very pleased with our operating performance and position, be it the core rent-to-own business, certainly the RentWay integration or the financial services roll-out and results that we are experiencing.

Now let me take a few minutes and update you with regards to the Perez matter in New Jersey. As we noted in the earnings release the company has taken a charge for that case because we believe, given the applicable accounting standards, the rulings and developments in the case to date and our disclosure obligations as a public company that a loss, although not certain, is now probable. The amount we recorded reflects Management's belief as to the appropriate accounting charge at this time. As you will recall, New Jersey is one of the few states in which there is no existing rent-to-own legislation. As a reminder, following the Robinson settlement in 1999, we made several changes to our business in that state that we believed was in compliance with New Jersey law. You will recall that upon the original filing of this case four years ago, the trial court in this matter dismissed the case, and the Appellate Court in New Jersey Avenue affirmed that decision. Unfortunately the New Jersey Supreme Court disagreed. And once we received their ruling, we changed our business practices in New Jersey in a way which we believe is in compliance with New Jersey law today. This decision effects only our New Jersey operations and, while the changes had a significant impact on those operations, we do not believe that they will have a significant impact on our operations company-wide. This case is now back at the trial court where it began. No class has been certified in the case and no judgment or finding of liability has been entered against the Company. Obviously we are going to vigorously defend this matter while exploring opportunities to resolve it on reasonable terms. However we believe that taking the charge at this time is appropriate given the reasons I stated. With that update we would now like to go ahead and open the call up for questions and give you some further commentary. Operator?

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QUESTIONS AND ANSWERS

Operator

[OPERATOR INSTRUCTIONS]. Your first question comes from the line of Dennis Telzrow with Stephens Incorporated.

Dennis Telzrow - Stephens Inc - Analyst

Good morning, gentlemen, good quarter.

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

Good morning, Dennis. Thank you.

Dennis Telzrow - Stephens Inc - Analyst

Maybe Robert or whoever wants to comment on, I guess if I looked at your guidance for the first quarter and then sort of push the numbers in the latter half of the year it sounds like you're telling us there's more pressure or you mentioned more dilution in the second and third and fourth quarter. I'm trying to understand that a little bit.

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

You are probably speaking in regards to my prepared comments related to the RentWay integration. And you know, what we indicated early on when we completed the acquisition is that we do anticipate RentWay to add \$0.01 to \$0.02 in operating earnings in 2007 and we still continue to believe that. However, we really hadn't given any guidance in how we view that specifically throughout the quarters. And so what we were trying to communicate with you this morning was that given the uptick in pay outs in the first quarter we would anticipate there to be some accretion from RentWay in the first quarter, that to flatten out in the second quarter or break even if you will, given those payouts, that extra incremental revenue or gross margin for the pay outs are kind of gone in the second quarter. But then couple that with the merged stores, as you know when we merge locations there's a deterioration in the top line in that merged revenue from some lost accounts. So that's going to impact us in the third quarter along with the seasonal nature of the third quarter in general. So we expect that to have some dilutive impact in the third quarter and then, as always, a strong fourth quarter that we believe will be accretive. So for the year still \$0.01 to \$0.02 so with that with that fourth quarter accretion being at a run rate if you will of being able to realize \$0.20 in 2008.

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

Dennis, this is Mitch. The other thing I would add when you think about our first quarter guidance relative to the year, that third quarter seasonality is always, has always been there as far as a drop in revenue and therefore a drop in earnings. Now in '06, you recall we had an extra Saturday in the third quarter. And that kind of masked if you will that seasonality when you look at our EPS spread for 2006. So without that extra Saturday falling in a quarter which is a big day for us. which is a big day for us, as you know very well Dennis, most of our customers on Saturday, on the weekend. So that masked that normal seasonality. So when you think about the spread for this year, look back a few years and think about 2005 at least and you will see that the seasonality in the summer quarter. Don't get fooled by 2006 because of the extra Saturday.

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Dennis Telzrow - *Stephens Inc - Analyst*

That's very helpful. And one more question, Mark, you commented about the financial services so it certainly sounds like it's on course with your expectations. Is this 200 to 250 sort of the number you could sort of max do or is there larger goals somewhere down the road?

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

Well, yeah, it's certainly this year, and consistent with what we said in the past that we felt very comfortable that we could add 200 to 250 a year. I feel very comfortable at this time with that number as it relates to '07. Could we in fact pile that up higher if you will in the forward years? It's certainly possible. I'm hesitant to say that we are going to do that at this point, Dennis, you want to grow as big and as fast as management can handle and I guess my way of thinking is I would rather have 200, 250 real good ones as opposed to 320 not so good. So I think we are going to manage it based on the bench strength and our ability to roll them out successfully. And so at least for this year I'm staying in the 200 to 250 and we will revisit whether we want to dial that up further in the forward years maybe when we get to the end of '07. How's that?

Dennis Telzrow - *Stephens Inc - Analyst*

All right. Thank you very much.

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

Okay, thanks, Dennis.

Operator

Your next question comes from the line of Arvind Bhatia with Sterne Agee & Leach.

Arvind Bhatia - *Sterne, Agee and Leach - Analyst*

Good morning guys.

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

Morning, Arvind.

Arvind Bhatia - *Sterne, Agee and Leach - Analyst*

And congratulations on a good quarter. My first question is on the RentWay store closings. I know you closed about 19, 20% of the stores that you acquired. And we are given that these were underperforming stores. So is there a way to look at what those stores might have represented in terms of revenue for RentWay? And then if you could provide some more color on the pay day loan business? Mark, you indicated that the instore model is doing better. What differences are you seeing? Is it more traffic, is it revenue or is it sort of on an operating basis because you have lower cost you are bringing more to the bottom line and that's the difference you are speaking to? Just some more color on what's really going on on the two formats.

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

Let me take your last question first and then I will throw it back to these guys to answer the first one. In terms of the Financial Services, again the instore, the kiosk if you will, the transaction counter in the back of the store next to the existing rent-to-own transaction counter, where the box in the box, we put in the dividing wall, separate entrance and treated it somewhat as a stand alone businesses, inside the four walls but which might appear to be two different businesses, certainly the cost to put these in is a little bit less on the instore, about a \$30, \$40,000 investment for an instore versus maybe a \$60,000 investment for a box in the box.

But even setting that aside what we are seeing is a larger number of outstanding loans in the instore and that of course then drives additional revenue because of the larger base of loans outstanding. The average amount of the loans is not much different between the two. So it's really just more -- and then I guess into intuitively it makes a little sense. By default you have more traffic coming inside the four walls and they are able to capture between the two. I think operationally I would say -- and I don't mean this -- but just because all the co-workers are inside the same four walls kind of in the back together there does seem to be a little bit more cohesiveness if you will working together. And again that's just by the nature. In the other case where you've got the [mizing] walls and then those couple of co-workers are in their environment if you will and the rent-to-own is in their own environment just by default you don't have the opportunity to work together as much as you would being in the same environment. And so, are they doing a better job of cross-selling and or working together to drive business in both businesses? You know, intuitively that's what we believe is happening. But bottom line is we are just seeing a larger base of loans out which brings in more revenue and then coupled with a little bit lower cost, it obviously make it a little bit more attractive from a profitability standpoint as well. So, I we still need a little -- I said another quarter or two, Arvind and we are still wanting to look at both businesses and how they complement one to another, even though the box in the box may not be doing quite as well, are they driving more traffic into the rent-to-own than the other one? And so there is still some more that has to get done which still requires a bit more time to look at traffic flow and behaviors between the models and that's what we are still working on. But again early indication is instore appears to be a little more favorable.

Arvind Bhatia - *Sterne, Agee and Leach - Analyst*

So of the 200 to 250, is there a way to think about how many, are you going to be 50, 50, and then --

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

Well, frankly the plan with the next couple of hundred like we've done with the first 150 is more at this point a by product of availability space in the store that we are going in. In other words, if the space is larger and the frontage is broader, it's more conducive to put in the box in the box, we are using those to do so. Obviously if you've got a little less space and or a narrower store front you can't afford to give up that frontage, so by default that becomes an instore. And now it's probably two-thirds instore, one-third box in the box. With 150 or what will then be 300 there will still be a pretty good -- that's still a large enough sampling between the two to get the learning we we need to make the decisions we need to make.

Arvind Bhatia - *Sterne, Agee and Leach - Analyst*

But if you are doing more of the instore does that your, to redirect Dennis's question, is it fair to say your base of openings could accelerate because it's easier to do the instore?

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

That's a fair question, it's -- but I think I'll reminds you of some of the challenges we have in the past and to some extent today what takes time is the licensing and the permitting more so than building them out. But you're right, what might take a day to

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put in an instore might take a week to do a box in a box, so I'm not sure at the end of the day that has a big difference but a little bit anyways.

Arvind Bhatia - *Sterne, Agee and Leach - Analyst*

Got it.

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

And then your other question about the closings.

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

Yes, Arvind, on those RentWay stores, you probably have calculated the 782 stores were in about the, on a monthly basis in the low to mid 50s, maybe about \$55,000 in average total revenue.

Arvind Bhatia - *Sterne, Agee and Leach - Analyst*

Okay.

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

The 20% or so that we closed are in that \$40,000 a month average. So the other 80% are somewhere around \$60,000 that's what we did anticipate and obviously have been able to grow those that, \$60,000 up to our \$70 plus average.

Arvind Bhatia - *Sterne, Agee and Leach - Analyst*

One last question on the inventory, the comment that you made Mitch on, for the fourth quarter, the 22.8% held for rent, was expected because of RentWay. So do they have more product at the store level? Were you doing anything to, I guess, I don't know if cleaning it up is the right term but should we expect that number to come down as it does, seasonally, I guess last year had you about 150 basis points decline linked quarter. Is that something that we should expect this year as well?

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

I think a couple of things. It's not so much -- it's not at all because they have more inventory than a typical Rent-A-Center store. They have about the same amount of inventory held for rent but of course their inventory on rent is lower because they are smaller stores, smaller revenue stores, so you have got the same amount held for rent and you have 800 stores coming in the system with less inventory on rent. So that changes the number, plus the 150 or so we closed we still have that inventory, we got 150 extra stores worth of inventory. So that's what drives the number up. Yes, I would still anticipate seasonal drop at the end of the first quarter. I would not expect, we haven't forecasted it -- I would not expect us to get as low as we were at the end of the first quarter last year. We will still have a seasonal drop but not as low percentage-wise as we were at the end of last year. It's not like we will have all 150 stores we closed, we will have all that extra inventory gone or obviously the inventory on rent at RentWay will not be as high as a typical Rent-A-Center by the end of the first quarter. So I would look for a seasonal drop but overall percentage won't go as low as last year.

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Arvind Bhatia - *Sterne, Agee and Leach - Analyst*

That's very helpful. Thank you.

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

Thanks, Arvind.

Operator

Your next question comes from the line of Henry Coffey with Ferris Baker Watts.

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

Good morning everyone and again let me join my congrats on a great quarter. I was wondering on a couple of issues, one, the rent-to-own business, are you seeing any particular change in mix driving that same store sales or is it heavily skewed towards TVs? Or I know you mentioned three or four different items but I was wondering if you could identify what the heaviest driver was.

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

From a product perspective, now it's -- I mean the flat panel technology is helping. It's not necessarily -- it's replacing products we rented before, projection TVs are not flat panel and they got out at a higher price, that's not driving the comp but we probably rented a few extra because of flat panel technology but it's really replacing the older technology, which is -- again it goes out at a higher price. So that's it. But we are up in all categories. Appliances, computers have been very strong for us, furniture honestly has been pretty flat. But it's really been a spread from a product standpoint.

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

And you're pretty much product neutral in terms of your overall pricing scheme, correct, in terms of margins realized.

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

Correct.

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

And then just changing gears to the Financial Services business, given that -- two questions and I'll just be quite and listen, one, is it all a loan product, you know some form of payday loan that's going out the door, or are you seeing meaningful revenue come from other services like check cashing and second, can you give us some perspective on how you are going to react to where you put stores given current regulatory developments?

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

Yes, let me make sure I understood your question because you were breaking up a little bit. I think you were asking about the mix of revenue coming from various products, be it payday loans themselves and/or check cashing fees, et cetera, and I think your follow up question was how do we think about locations and states given the regulatory environment?

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Henry Coffey - Ferris, Baker, Watts - Analyst

Yes. That's it exactly.

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

Okay. To your first question in terms of the revenue and where it's coming from we are offering a variety of products and services if you will in the financial stores be it the check cashing, the payday loans, money transfer, we've been doing and so forth. Suffice it to say that the vast majority of revenue, 90% plus is coming from the traditional payday loan product. And our expectation is that would probably continue or remain pretty consistent going forward. In terms of the locations we are looking to add, we are continuing to practice what we've been preaching in that we are only focusing on states that have enabled legislation if you will within that financial service arena. And there are about 35 or so states, maybe 38 today, that have enabling legislation. There are one or two of those that are maybe a little bit more questionable and so we are focusing on others. But generally any state that has legislation in place or a product that conforms to the legislation is where we are focusing our time and energy.

Henry Coffey - Ferris, Baker, Watts - Analyst

Thank you.

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

Thanks, Henry.

Operator

Your next question comes from the line of Jeff Schollaert with Wachovia Securities.

Jeff Schollaert - Wachovia Securities - Analyst

Great, thanks. A couple questions on, just some commentary on the Financial Services business. Do you have a good sense of the amount of cross-selling you are able to achieve here in terms of if it's a new customer that's coming in just for the Financial Services product?

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

Well, that's some of the learning I was referring to a little while ago, Jeff, in terms of customer behaviors between the two products, which one came first and how much overlap if you will is there between the two. Our experience in the more mature stores be it those that we acquired almost two years ago when we got into the business and or those that we've opened call it a year or so now, to where we've got a large enough base to manage or look at that. It's not significant and we did not anticipate that it ever would be. It's about 20% or 25% overlap between those two products or services. I'm not sure we are in a position to tell you which has come first, whether that overlap exists -- well, I say that, by default more of that is the rent-to-own may have been first because it was an established business. And so where the overlap is in fact coming up it typically is been a rent-to-own customer for multiple years, and whether they are active in the rent-to-own is not always, sometimes they are not but sometimes they've been a customer there and are now going over for different reason or need using the Financial Service product. But about 20 or 25% overlap where it does exist. More often than not it was probably rent-to-own first but that's one of those areas we still need a little bit more time to get some further learning if you will.

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Jeff Schollaert - Wachovia Securities - Analyst

Great. That's very helpful. And the second question is on your RentWay stores, from what you are seeing to date are you still targeting sort of a 2009 time frame when it's achieving a run rate in line with your Rent-A-Center stores?

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

Yeah, we previously communicated that after the third year so to speak there would be at about 90% of the Rent-A-Center core store from a revenue run rate and perspective and that has not changed. So by the end of '09 they are around 90% of a typical Rent-A-Center store.

Jeff Schollaert - Wachovia Securities - Analyst

Great, thanks. And then last question, will the RentWay stores go into the comp base in Q4 of '07?

Robert Davis - Rent-A-Center - CFO

No. They have to be in their entirety in the period in its entirety so they won't come in until the first quarter of '08.

Jeff Schollaert - Wachovia Securities - Analyst

Okay. Great. Thank you.

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

That's the current quarter we're in.

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

The kept stores.

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

They will come in kind of in the first quarter of 2008.

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

And merged stores..

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

The second quarter I recollect there's a quarter delay, we said.

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Jeff Schollaert - Wachovia Securities - Analyst

Thank you, guys.

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

Thank you.

Operator

Your next question comes from the line of Chris Horvers with Bear, Stearns.

Chris Horvers - Bear, Stearns - Analyst

Good morning.

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

Good morning.

Chris Horvers - Bear, Stearns - Analyst

So far in looking at the merged stores and the RentWay stores how has the transfer process occurred with existing accounts there? I think you talked about historically around 50 to 70%. How do you think you are falling out so far?

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

It takes awhile of correcting that. When you talk about the fall off being in the 50% range, it takes, you know, that happens over -- of course the majority happens up front but it happens over six months, six to 12 months really with probably the most accelerated drop in the first 90 days but it really takes at least six months to tell if you we beat that, beat that number or not. So far what we've seen in most of the stores happened in December when we merged them and so far we are pleased with the numbers. As we said we are pleased with the way the integration has gone, the transfer of has gone pretty smoothly, with the process we used and so far so good.

Chris Horvers - Bear, Stearns - Analyst

Okay. That's good. And is there, are there other at risk states as we think about potentially having to go to an installment model from a rent-to-own model? I know it was a Minnesota preview, you had something in Minnesota a few years ago and now New Jersey. What are the other at risk states?

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

We don't believe so, Chris. In fact again as we've said there are only three states that do not have enabling legislation, if you will. New Jersey of course being one and Minnesota and Wisconsin where we really, well, we don't operate rent-to-own stores in those states and haven't for a multitude of years. All the other states have positive enabling legislation so we don't view there are any risk in the other states. No.

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Chris Horvers - *Bear, Stearns - Analyst*

Thank you.

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

Thanks, Chris.

Operator

Your next question comes from the line of Justin Boisseau with Gates Capital Management.

Justin Boisseau - *Gates Capital Management - Analyst*

Hi, thanks. A question about your margins, it looks like your EBITDA margin is projected to be roughly flat with year over year on a positive 1% to 2% comp. What sort of comp do you all think you all need to help improve margins on a year over year go forward basis?

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

We have historically commented, Justin, that you ought to take the one or 2% comp to break even, or to keep margins flat. It will tell you that a large portion of that margin guidance that we have given to you for 2007 is attributable to the RentWay integration. And given the fact that we are giving a comp of 1% to 2% which excludes comp numbers from RentWay which is which was mentioned in the prior question, had we not had the impact of the RentWay stores we would expect that margin to expand slightly. But given the RentWay integration we are currently expecting that margin to remain flat in 2007.

Justin Boisseau - *Gates Capital Management - Analyst*

And then in terms of the cash flow thoughts for next year, would you expect your working capital to be a source or use of cash and what sort of CapEx requirement do you think you'll have for next year?

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

Yes, right now we are estimating cash flow in 2007 of roughly \$130 to \$150 million, free cash flow, operating cash around \$200 to \$220. And that really starts out with EBITDA number we talked about approximately \$430 million. Net interest expense off that number is \$90 million. Capex expectations right now is up to \$75 million. You back out of that number. Working capital will be a use. We will continue to invest in working capital and inventory to grow the business. That investment is about \$60 million. And our cash tax expectation currently is around \$65 million. So if you start out with that \$430 and back out the \$90 for interest \$75 for CapEx, \$60 for working capital, and \$65 for cash taxes you get into that \$130 to \$150 million range for free cash flow. And that's, you know, that then is what we would look to deploy the number of factors be it, delevering the balance sheet, opportunistic share repurchase, additional acquisitions, so forth and so on.

Justin Boisseau - *Gates Capital Management - Analyst*

Okay. Then finally in terms of the inventory build over the course of time what's driving that? Is it something you expect to see continue year after year or is it a one time build up of something like flat panel televisions? or what's behind that?

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

Well, a couple of things. First and foremost, we've got, if our revenues, if we were forecasting revenues flat, you know, we would make the assumption that the net investment in working capital would be flat. But given the guidance of 1% to 2% in same store sales we need to continue to invest in that inventory to support that comp. But then also given the RentWay acquisition there will be additional purchases in RentWay as we migrate their inventory mix into ours, which generally comes at a higher cost than what RentWay was purchasing, or a higher inventory because of that higher cost and as a by product comes the higher revenue stream, too. That investment in networking capital is a function of supporting the comp and supporting the mix transfer in the RentWay locations.

Justin Boisseau - *Gates Capital Management - Analyst*

Terrific. Thanks.

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

Thank you.

Operator

[OPERATOR INSTRUCTIONS] You have a question from the line of [Barney Wong] with [inaudible] Asset Management.

Barney Wong - *Analyst*

Hi, guys.

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

Morning. What are you guys seeing in terms of your revenues -- I mean your receivables and the kind of the delinquencies. Have you guys seen any sort of negative trend at this point. No, as I mentioned in my prepared comments, collections in the fourth quarter and for the year actually ran slightly below last year from a delinquency standpoint. So, no, it's trending positively. It's very consistent.

Barney Wong - *Analyst*

Great. Thank you.

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

Thanks, Bernie.

Operator

[OPERATOR INSTRUCTIONS]. Mr. Speese, at this time we have no further questions. Are there any closing remarks?

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

Well, again, ladies and gentlemen on behalf of the company we appreciate your joining us this morning. As always we appreciate your support of the company. As we mentioned we are obviously very pleased with our current operating results and feel good as we begin this new year. We certainly look forward to reporting back to you I guess in late April with an update on our first quarter results. So again thank you very much. Have a great day and, as always, we are available for any follow up questions. Thank you.

Operator

This concludes today's Rent-A-Center fourth quarter 2006 earnings conference call. You may now disconnect.

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