# THOMSON REUTERS STREETEVENTS **EDITED TRANSCRIPT** RCII - Q1 2013 Rent-A-Center Earnings Conference Call

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# **OVERVIEW:**

RCII reported 1Q13 revenues of \$819.3m, net earnings of \$46.5m and diluted EPS of \$0.80. Expects 2013 revenue growth to be 3.5-5.5% and diluted EPS to be \$2.95-3.10.

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### **CORPORATE PARTICIPANTS**

David Carpenter Rent-A-Center Inc - VP of IR Mark Speese Rent-A-Center Inc - Chairman & CEO Mitch Fadel Rent-A-Center Inc - President, COO Robert Davis Rent-A-Center Inc - CFO

### **CONFERENCE CALL PARTICIPANTS**

TJ McConville Raymond James & Associates - Analyst Arvind Bhatia Sterne, Agee & Leach, Inc. - Analyst John Baugh Stifel Nicolaus - Analyst John Rowan Sidoti & Company - Analyst DeForest Hinman Walthausen & Co. - Analyst James Ellman Ascend Capital - Analyst

### PRESENTATION

### Operator

Good morning and thank you for holding. Welcome to Rent-A-Center's first-quarter 2013 earnings release conference call. At this time all participants are in a listen-only mode. Following today's presentation we will conduct a question-and-answer session.

(Operator Instructions)

As a reminder, this conference is being recorded Tuesday, April 23, 2013. Your speakers today are Mr. Mark Speese, Chairman and Chief Executive Officer of Rent-A-Center; Mr. Mitch Fadel, President and Chief Operating Officer; Mr. Robert Davis, Chief Financial Officer; and Mr. David Carpenter, Vice President of Investor Relations. I would now like to turn the conference over to Mr. Carpenter. Please go ahead, Sir.

### David Carpenter - Rent-A-Center Inc - VP of IR

Thank you, Kirk. 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 first quarter. If for some reason you did not receive a copy of the release, you can download it from our website at investor.rentacenter.com. In addition, certain financial and statistical information that will be discussed during the conference call will also be provided on the same website.

Please note the following additional important information. The statistical information will also include the 2013 first-quarter segment data for rental merchandise and assets. We apologize that this information was inadvertently omitted from our first-quarter earnings press release issued yesterday. Again, the 2013 first-quarter segment data for rental merchandise and assets is available on the financial information page at investor.rentacenter.com. 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 in 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 the earnings press release issued yesterday, as well as our annual report on Form 10-K for the year ended December 31, 2012. Rent-A-Center undertakes no obligation to publicly update or revise any forward-looking statements.

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

### Mark Speese - Rent-A-Center Inc - Chairman & CEO

Thank you, David, and good morning, everyone. Let me begin by saying how pleased I am with the results in our growth initiatives, specifically RAC Acceptance and Mexico. That said, we had a challenging and difficult first quarter in our Core business. Results that, we believe, were negatively impacted by the macro environment from the delayed issuance of federal income tax refunds, rising fuel prices, and the higher payroll taxes. While we had anticipated and guided to down revenues for the quarter in our Core business, it was greater than expected with our Core US revenue down \$58 million year over year. And while revenue growth in RAC Acceptance and International helped to partially offset the Core decline, our overall results were disappointing, with total revenue down 1.9%, and net earnings down 10.6%. Mitch will provide more quarterly details on each of the business segments in a few moments, but suffice it to say, it was challenging.

In regard to the growth initiatives, I do remain very excited. In the RAC Acceptance business, revenues were up 45% in the quarter to over \$127 million, and now represent nearly 16% of our total revenue, and 20% of our total operating profit. Our operating profits continue to grow as the stores mature. For the quarter, operating profits were up \$13 million year over year, totaling \$16 million in the quarter. Very impressive and on plan.

Regarding International, and specifically, Mexico, their results were also good and in line with our expectations, with revenue growing over 150% in the quarter and totaling \$9.5 million. We also opened 20 new stores in the quarter and now operate 110 in total. We remain very excited about the long-term opportunities Mexico provides for us. Robert is going to provide more specifics on the revised 2013 guidance. As I noted in the earnings release last night, given the difficult first quarter, resulting in lower-than-expected ending portfolio in the Core business, we are lowering our revenue and EPS expectations for the year. We are now expecting total revenue growth positive 3.5% to 5.5%, and EPS now in the range of \$2.95 to \$3.10. Of course, that does include the approximate \$0.25 drag in earnings due to the international initiatives.

We have faced headwinds before, and while clearly disappointing, we believe that the Company remains well-positioned and well-capitalized to execute its long-term strategy. The trends that we have seen in the Core US business over the last several weeks are encouraging, up period over period, and support our belief that the first quarter was an anomaly, similar to what was seen in the broader retail market, and the need for our products and services remains strong. We are focused on regaining our portfolio throughout the year, and have a number of initiatives in place to do so.

I do want to thank all of our co-workers for their continued hard work and contributions, and as always, we appreciate your support as well. With that, let me turn the call over to Mitch to provide you more specifics on the operating results themselves. Mitch?

### Mitch Fadel - Rent-A-Center Inc - President, COO

Thanks, Mark, and good morning, everyone. As Mark mentioned, we are very pleased with our results and their growth initiatives, RAC Acceptance and Mexico; however, we believe our Core US results were impacted by the macro headwinds. In overall same store sales, we had forecasted the quarter to be down 2%, and we ended up down 4.3%. In the Core segment, we had forecasted the quarter to be down about 4%, and we ended up down 8.9%. In the Core, we went into the quarter with a portfolio of accounts that was behind the year before, which is why we forecasted the Core at a negative comp of about 4%.

With the delayed issuance of income tax refunds that are a key part of our customers' total income, rising fuel prices, and the higher payroll tax effect, we missed our forecasts on both rental income and the sale income that is inflated by that income tax money being in the economy. The lower-than-expected revenues in the first quarter were equally split between rental income and sales income. So going forward in the Core, our



plan is to drive additional traffic through strategic promotions and advertising, as we are 100% focused on getting that portfolio of accounts up to and above last year's comparable numbers.

As Mark mentioned, we are seeing some of our implemented initiatives work in a very positive way, and our recent trends within the portfolio have been good. Our collections metrics remain in line with our expectations, and our customer losses in the Core rent-to-own stores came in at 2.4%, at the lower end of our historic ranges. Given the softness in the quarter, our inventory help for rent in the Core came in at 25.8%. As Dave mentioned, those numbers are now posted on our website, but it came in at 25.8%, higher than we would like at the end of the quarter, but we can work that down in the current quarter.

In the RAC Acceptance segment, as we have mentioned, overall we are pleased. Revenue of \$127 million, operating profits of about \$16 million, and a positive comp of almost 34%, positively impacting our overall comp. Our kiosk count is over 1050. We have already got over 100 kiosks inside of h.h. gregg, a recently added partner, and our delinquency metrics and customer keep rate metrics remain in line with our expectations. Overall, lots of positives in the RAC Acceptance segment.

In Mexico, as Mark mentioned, we added 20 more stores and end the quarter with 110 stores and an 80% comp, another number that also positively impacted our overall count. And we are currently on track to add 60 there this year, and we are on track to achieve four-wall breakeven in the country by the end of the year. Overall, a very good quarter in RAC Acceptance and Mexico, and improving recent trends in our Core business. Our focus will remain on continuing those positive trends in the Core, and for that, I would like to thank our 20,000-plus co-workers for all of their efforts as we improve the quality of life for our customers. Robert?

### Robert Davis - Rent-A-Center Inc - CFO

Thank you Mitch. I want to spend a few moments updating everyone on the financial results during the quarter, and then review our revised 2013 annual guidance, after which time we will then open the call for questions. As outlined in the press release, our total revenues were \$819.3 million during the first quarter of 2013, an approximate 2% decrease as compared to the first quarter of last year. This decrease was comprised of the following same store sales comparisons -- US Core RTO was down 8.9%. Meanwhile, RAC Acceptance advanced approximately 34%, and Mexico had a same store sales increase of 80%.

However, given the composition of our sales mix, in that the US Core RTO revenues are in excess of 80% of our total revenue, our consolidated Company-wide same store sales comp declined approximately 4.3%. And, as a result, our net earnings in the quarter declined approximately 10.5%, to \$46.5 million, for a total of \$0.80 in diluted earnings per share. These results do include about a \$0.06 drag on the earnings in the first quarter, due to the investment and ramp-up of our international growth initiatives. As expected, these investments, along with the impact of our down comp, had a similar impact on operating margins in the quarter, which were down quarter over quarter and equated to 9.7%. Our first-quarter EBITDA equaled \$98.7 million, and a margin of 12%. Positive cash flow during the first quarter exceeded \$113 million.

And during the quarter, the Company repurchased over 465,000 shares of stock for approximately \$17 million, repaid over \$46 million in indebtedness, which was a combination of a mandatory payment and a reduction in the revolving lines of credit that were outstanding at year-end, as well as made our eleventh consecutive quarterly dividend payment. And we ended the quarter with approximately \$82 million in cash on hand. The combination of these factors allowed us to lower our leverage ratio from the end of the prior year to 1.52 times as of March 31. We continue to believe our balance sheet is in great shape and as such, we believe we remain well capitalized to execute on our growth initiatives, and continue to provide long-term value to our shareholders.

In terms of guidance, given the results during the first quarter, both operationally and financially, we have revised our annual 2013 guidance. We now expect total revenues to increase between 3.5% and 5.5%. And with this projected increase in the top line, we expect our same store sales for 2013 to range between a positive 1% and positive 2%. Overall diluted earnings per share for 2013 are now expected to be in the range of \$2.95 and \$3.10, which includes an approximate \$0.25 drag, primarily relating to our international growth initiatives. And as a result of the continued growth in ramp-up of RAC Acceptance, we expect our gross profit margin to decrease approximately 50 basis points on a consolidated basis in 2013, although we expect total gross profit dollars to be up approximately 4.5%, as compared to 2012.



We expect both our operating and EBITDA margins to decline approximately 50 basis points while we continue to invest for growth and for the long term. In terms of EBITDA and free cash flow, the Company believes EBITDA will approximate \$400 million for the year, with free cash flow to be in the range of approximately \$55 million. The 2013 guidance does not include any potential impact of any share repurchases, of common stock that the Company may make, changes to future dividends, material changes to outstanding indebtedness, or the potential impact of acquisitions, dispositions, or store closures that may be completed or occur after the date of this press release. With that, that concludes our prepared comments. Operator, would you please now open the call to questions?

### QUESTIONS AND ANSWERS

### Operator

(Operator Instructions)

Budd Bugatch, Raymond James.

### TJ McConville - Raymond James & Associates - Analyst

Good morning, Mark, good morning, Mitch, good morning, Robert. It's TJ McConville filling in for Budd. Thanks for taking my questions. I have actually one on each of the segments. Guys, on the Core business, realize we're talking about a delay in the tax refunds, and increased pressure on some disposable income with the customers. I would have expected, I think, a little bit more gross margin benefit in the quarter in the Core segment. Anything you can offer there as to why we were only up 60 basis points, when we may have had far fewer early payouts this year? Have anything to do with any of the merchandise coming from RAC over to the Core business?

### Mark Speese - Rent-A-Center Inc - Chairman & CEO

No, TJ, I think it's -- the 60 basis point improvement was based on less payouts. The revenue miss, remember, in the first quarter was about 50% rental income from our forecast, at least, from that number where we thought the Core was going to be down 4%, and it ended up down over 8%. That was split between sales and rental income, at about 50% and 50%. So, it wasn't all just sales. Had it all been sales, probably that gross profit impact would have been even more positive from a percentage basis. But, it was about half and half. So, that is why the 60 basis points, maybe you were expecting more, but remember, it is about half and half on what we missed our guidance by.

### TJ McConville - Raymond James & Associates - Analyst

Okay. Fair enough. And that difference between the down 4% and down 8%, was that all three buckets, or was that specifically the tax refund delay issue?

### Robert Davis - Rent-A-Center Inc - CFO

Yes, I would say all three buckets. I think the tax -- my personal opinion is the tax refund delays was the number one reason. The rising fuel prices up through February was the second reason. And then the payroll tax would be third. I don't know that I would put them equal. I think I would weight them more one-two-three, that way.



### TJ McConville - Raymond James & Associates - Analyst

Okay. That's helpful. In RAC, guys, we're always interested to hear about the competitive environment. Any new developments you seeing on that front, and whether or not you are seeing any [encouragence] from some of the other operators into new partners, or maybe some of your existing partners, if I can ask that?

### Mitch Fadel - Rent-A-Center Inc - President, COO

Well, the pipeline remains strong. Our competition out there in that business model is more in the virtual space. Mostly in the virtual space, but, as far as the manned kiosks, there's nothing new going on there. The pipeline remains strong with all our partners, and new ones like h.h. gregg, and some more new regional players coming on, as well.

### TJ McConville - Raymond James & Associates - Analyst

And then lastly for me guys, I appreciate you indulging all three. But, notice in the supplemental here, that you are calling for four-wall breakeven in the international business by 2013. Certainly, very good news to hear. What does that imply, do you think, Robert, if you might hazard a guess at what that would look like on a reported basis? What kind of EPS drag might that look like? I am sorry, beyond this year. Beyond the \$0.25 this year.

### Robert Davis - Rent-A-Center Inc - CFO

Yes. We haven't provided guidance beyond this year, as you well know. But, when Mitch describes four-wall breakeven, we're talking about the store level. By the end of the year, not cumulative for the year, so November, December, one of those two months, is what we are forecasting for to be four-wall breakeven. How that translates into 2014 really depends on the rate of growth and how many stores we are going to open and the timing thereof.

But suffice it to say, if we stop closing stores at the end of 2013 -- stop opening stores in 2013, that drag, obviously, wouldn't occur in '14. But if I were to hazard a guess, I don't know that we would be overall cumulatively profitable in 2014, but what we've described is the rate of dilution would diminish. So \$0.25 this year would become something much less than that in 2014.

### TJ McConville - Raymond James & Associates - Analyst

That is very helpful, and I appreciate that, guys. Best of luck on the rest of the year and again, thanks for taking the questions.

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

Thanks TJ.

### Operator

Brad Thomas, KeyBanc Capital Markets.

### **Unidentified Participant** - - Analyst

Hey guys, this is actually Jason standing in for Brad this morning. How are you doing?



### Robert Davis - Rent-A-Center Inc - CFO

Good morning.

### **Unidentified Participant** - - Analyst

I was wondering if you guys can discuss, I know you track a lot of metrics in terms of items per agreement, agreement per customer, pickups, deliveries. Which one of -- what of those metrics are you seeing really hitting an inflation point that tells you that things are really improving as we move into the second quarter and beyond?

### Mitch Fadel - Rent-A-Center Inc - President, COO

Good question, Jason. The number one metric when we talk about the demand over the recent weeks, the number one metric there is deliveries, customer deliveries. So that is what has gone in a real positive direction the last several weeks.

### **Unidentified Participant** - - Analyst

Okay. And then, by our calculation it seems that in your, at least in your Core RTO, the SG&A per store seems to be coming down. Is there anything that you guys are doing within the stores, or what is really driving that down? And how much more do you think you can really pull out of the store operating costs?

### Mitch Fadel - Rent-A-Center Inc - President, COO

No, nothing specific that is a big focal point, if you will. We are always focused on managing our expenses, and we continue to do so. We talked about, in the past, setting up a more sophisticated spin management organization to manage all of our costs. And what you're seeing is a reflection of the continuation of that focus.

### **Unidentified Participant** - - Analyst

And then along with that, you mentioned last time a new POS system. Can you give an update on the timing of that, and what kind of spending you expect this year and into '14?

### Mitch Fadel - Rent-A-Center Inc - President, COO

Our 2012 -- or 2013 CapEx forecast is \$120 million. Roughly \$20 million of that is expansion CapEx. The remaining \$100 million is split between technology and store maintenance. So call it \$50 million. Some of that is for the new POS, about 40% of that \$50 million is for the new POS, call it \$20 million for 2013. We expect the rollout of POS system to begin towards the end of this year and really take place during the course of 2014. And at that point, it would be less development costs and more maintenance costs going forward.

### **Unidentified Participant** - - Analyst

And in terms of, once you start ruling out the SG&A impact, is that going to be a significant headwind in the back half, or into 2014, or pretty minimal?



### Mitch Fadel - Rent-A-Center Inc - President, COO

All of that is embedded in our forecast that we provided guidance to today.

### **Unidentified Participant** - - Analyst

Okay. Then, lastly, I was wondering if you can give an update on if you guys still have 18 stores in Canada? Do you have any plans, what kind of drag should we expect from those, or are they profitable for the year?

### Mitch Fadel - Rent-A-Center Inc - President, COO

They are not profitable yet. They are slightly negative, though, so it is not material. Our plan, we would like to franchise Canada and have those stores -- have a franchisee develop Canada force as we focus on Mexico and beyond. So that is our plan. We would like to get those sold and franchised. But the drag in the meantime is immaterial.

### **Unidentified Participant** - - Analyst

All right. Thanks a lot.

### Operator

Arvind Bhatia, Sterne, Agee.

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

Thank you. A couple questions. First one is on the same store sales guidance of plus 1% and plus 2%, Robert, that you mentioned. Wondering what that implies for the Core business, what you're giving there for Core. Then, second question on RAC Acceptance. Wanted to see if you could give more color on h.h. gregg and how the early -- I know you mentioned a little bit, but just some more color on how that is going so far in the 100 locations? When do we expect to have maybe 200 locations, or what the plans are and expectations overall?

### Mitch Fadel - Rent-A-Center Inc - President, COO

Well, in the same store sales, Arvind, obviously, the guidance that we've given is on a consolidated basis, to your point. And what that -- given the first quarter results, what that would imply for the balance of the year, is that it would turn and accelerate towards the back half of the year. We haven't given specific guidance on the Core. We did, obviously, for the first quarter, just given where we ended the year in terms of the portfolio. But we would expect the quarter to be positive within the fourth quarter from where it is today. So, a similar trend over the course of the remaining three quarters, as you would imply on the consolidated same store sales. Just given, it's the majority of the driver behind the comp to begin with.

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

Okay.

### Mitch Fadel - Rent-A-Center Inc - President, COO

And h.h. gregg, Arvind, it is going well. We are over 100 stores now. It's running, on average, at our model, actually slightly above our model. So, we are doing pretty well in those stores.



And we'll have all -- I know it is in the 180 range, I think, when we have them all done. We will have them all done by the end of the summer, certainly in time for the most important time of the year for the consumer electronics business, the fourth quarter. So they will all be done by the end of the summer. And it is going very well with them, and going well in the segment in general, but going well in the rollout with h.h. gregg.

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

And the final one, just more conceptual question, that we discussed this in the last conference call, as well. The question of, is there any sign at all that your RAC Acceptance business is attracting customers from the Core business at all? I know a lot of this is macro, but I didn't know if you guys had any more color there?

### Mitch Fadel - Rent-A-Center Inc - President, COO

Certainly, we like the fact that RAC Acceptance is growing our US rent-to-own business, as we talked about on the last call. And when you add them together, it does take some of the sting out of the Core, as far as the Core being down, and obviously the overall US business, when you add RAC Acceptance to it, is much closer to flat, even in a bad quarter. But, more specifically, when we look at actual customer overlap, it is very, very de minimis. Because we know our customers' names, and who is renting from us, and who doesn't rent from us anymore, and we look at that, it's like I said, whether it is an inactive customer or a current customer, very de minimis, the overlap. Obviously, there's some opportunity costs that you cannot track, where someone may have left that retailer in the past and gone to a Rent-A-Center store. But, when we look at customers that have actually done business with Rent-A-Center in the past, overlap to RAC Acceptance, it is very de minimis. So, then you can guess on opportunity costs being a little bit, but I'll tell you, it is surprisingly low, the overlap in the numbers of customers when we look at the actual overlap that we can track.

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

Great. Very helpful, guys. And good luck for the rest of the year.

### Mitch Fadel - Rent-A-Center Inc - President, COO

Thank you, Arvind.

### Operator

Laura Champine, Canaccord.

### **Unidentified Participant** - - Analyst

Good morning, this is Jason on for Laura today. I just wanted to touch upon, you discussed h.h. gregg a little bit. I just want to touch upon, do you guys have a better sense as to what the opportunity will be on the consumers electronics side as far as RAC goes?

### Mitch Fadel - Rent-A-Center Inc - President, COO

Well, we -- that is something that continues to be developed. We keep working with other electronics suppliers, electronics and appliance suppliers. The pipeline, like I said, is very full for this year for hitting that 350 net growth in RAC Acceptance. And beyond that, like I said, we are talking to anybody who sells electronics and appliances, whether it's a regional player, whether it's Sears, or Walmart, or any of the bigger ones even. So, Lowe's, Home Depot. We'll talk to all of them, and it takes some time to get them to agree to test it in their stores. Just about everyone we have ever tested with, we have ended up rolling out.



We will just keep working on it. But I can't give you number. We said three years ago, Jason, when we, well, back in November of 2010, I think we did in our Investor Day, and really rolled out this concept in earnest that we thought we could do 1000 stores in furniture stores. And here we are, we're going to end this year in the 1300 range. It is bigger we thought at the beginning, and probably on the electronics side, it is bigger than the number I'd give you right now. I can give you a number right now, and then if you end up doing business with one of those big ones I have already mentioned, the numbers quadruple, right? So, we continue to see it as a tremendous opportunity, but to give a specific number on opportunity would be almost impossible at this point.

### **Unidentified Participant** - - Analyst

Sure. Sure. If I could just follow up, within the Core business, can you give us some color as to the trends with tickets in the quarter?

### Mitch Fadel - Rent-A-Center Inc - President, COO

It has been pretty flat. It was pretty flat in the quarter, our -- there's been -- of course, there is some deflation in electronics. We have really made up for that, Jason, in the units per agreement. We have talked in the past about how those have trended up. And they continue to trend up.

We have been aggressive in pricing for packages for our customer to -- for our second unit within the agreement, adding in a sound system to a TV and so forth. We have been aggressive on our pricing from that standpoint. Though there has been some deflation in electronics, we have really made up for it by being aggressive on the -- with add-on rates. And our number of accounts per agreement has grown to the point where it has made the overall ticket pretty flat.

### **Unidentified Participant** - - Analyst

Okay. Great. Thank you very much guys.

### Operator

John Baugh, Stifel Nicolaus.

### John Baugh - Stifel Nicolaus - Analyst

Thank you, and good morning. I just want to be clear, Mitch, you commented that there really wasn't much of an impact on gross margin on the Core business from RAC. Presumably, there is some impact of your bringing that product in at a retail cost, or am I wrong?

### Mitch Fadel - Rent-A-Center Inc - President, COO

No, you are right. I was commenting on almost no impact on overlap of customers hurting the revenue there. On the product, it does bring down the gross profit margin in the Core a little bit. I think it has been in the 20 to 30 basis point range. It has grown over time, but it is still pretty small, like I said, probably around 30 basis points as we have looked at it.

So, not a huge amount there. And it is in our forecast. The question earlier on the margins was about how come they weren't a whole lot better with less payouts. And they were better in the first quarter because of less payouts, but I think the question was about how come they weren't a whole lot better than that. But RAC Acceptance as inventory coming back impacts the margins little bit. And that we know, and that we bake in. The question earlier, John, was about customer overlap, which has been very, very de minimis.



### John Baugh - Stifel Nicolaus - Analyst

Could you comment, going all the way back to inception with RAC, how the keep rate has changed, if at all? Has it been very constant, roughly, where is it? Is there any recent trend on that, and also the pricing metric? My recollection was you were aiming for a roughly 2.2 turn. Any commentary around that figure?

### Mitch Fadel - Rent-A-Center Inc - President, COO

The keep rate metrics have stayed very consistent in that 70% to 75% range. We have been thrilled with that. It would be nice if we could get them even higher, but the keep rates there at 70% to 75% have been about what we expected. Collections metrics have been what we expected. The rest of your question was on --?

### Unidentified Company Representative - Rent-A-Center Inc

Pricing.

### Mitch Fadel - Rent-A-Center Inc - President, COO

The pricing. We're not -- when a product leaves the system, we're not up to 2.2 yet because of the maturity of the stores, but we will get there as the stores mature. We are always playing around with the pricing a little bit, and testing different things, because it's --. We have an overall rent-to-own turn, and then we have the early purchase option. So, even though the transactional run in the higher 2's on a rent-to-own basis because of early purchase options, it will be down in the low 2's. And we are climbing every quarter when we look at that, John, as the stores mature, and we will get to 2.2. It is climbing towards that.

### John Baugh - Stifel Nicolaus - Analyst

Thank you. And then on the Core business, any color, going into the second quarter? Is the balance of portfolios down similarly to the end of the calendar year, down a little worse, given the first quarter?

### Mitch Fadel - Rent-A-Center Inc - President, COO

Similar. Similar. We anticipated being able to make up some ground in the first quarter relative to the year before and then didn't. But no, we are not in worse shape than we were, we're just not in better shape than we thought would come out of the first quarter in.

### Robert Davis - Rent-A-Center Inc - CFO

The other way to look at that, John, is the balance sheet, the on-for-rent inventory, in March of '12 was \$592 million, and as you recall, we were fighting to get back out of the hole at the end of the first quarter last year. We ended December of 2012 at \$597 million, so we actually ended up from on on-rent inventory standpoint, which is essentially the portfolio, if you will. Ended the first quarter of '13 at \$590 million, so slightly below where we ended the year, and a little bit below where we ended the first quarter of last year.

### Mitch Fadel - Rent-A-Center Inc - President, COO

And that's with deflation in the purchase amount. So we just didn't make up anything in the first quarter that we intended to, John.



### John Baugh - Stifel Nicolaus - Analyst

Got it, got it. And you mentioned advertising. Are you increasing ad spend as a percentage of rent? Your revenues are coming down, so if you just held it flat on a dollar basis, it would go up. Or are you increasing it on an absolute dollar basis? Or are you changing message, or increasing promotions? Any color there? Thank you.

### Mitch Fadel - Rent-A-Center Inc - President, COO

Good question. Right now, the percentage will be up because our forecasts and revenue is down. Mostly right now what our new CMO, I mentioned last quarter on the call, our new chief marketing officer that started at the end of 2012, mostly we're looking at moving some things around. We will investment spend if we see there (technical difficulty), so there may be a little of that going forward, not material from a standpoint of having to worry about them in our expense numbers. But there may be a little more investment there. But it is mostly changing message and possibly moving some of the advertising money around. But certainly, it will come out a little higher percentage because we are not going to cut the dollar amount, for sure.

### John Baugh - Stifel Nicolaus - Analyst

Thank you. Good luck.

### Mitch Fadel - Rent-A-Center Inc - President, COO

Thanks John.

### Operator

John Rowan, Sidoti & Company.

### John Rowan - Sidoti & Company - Analyst

Just one quick question. Obviously, you guys talked about sales being part of the impact here in the quarter, of being below your expectation. Obviously, that's early payout-option related. I'm just curious, if you were to look at the first half as a whole, are you getting early payouts -- more early payouts in the second quarter that you normally would have? And if you look at, again, in the first half of the year in whole, are you on track for what early payout revenue you would expect?

### Mitch Fadel - Rent-A-Center Inc - President, COO

No, John. If that early pay out money was coming in April, we wouldn't have had to probably lower our guidance as much as we did. But no. It's -there was less payouts than we anticipated, and in April, we are running similar levels to last year. So, no. Even though the money is in the economy, most of it in the economy now with income tax returns. I think the fact that they got out there late, John, changed the way people used them. It must have, because the payouts are down, and they are not higher in April than historical numbers.

### John Rowan - Sidoti & Company - Analyst

Okay. All right. Thank you.



Mitch Fadel - Rent-A-Center Inc - President, COO

Thanks John.

### Operator

DeForest Hinman, Walthausen & Company.

### DeForest Hinman - Walthausen & Co. - Analyst

Hi everyone. Probably just to build off that last question, and maybe help everyone's understanding. Can you talk about how the months progressed in the first quarter, because it sounded like, at least initially, on the fourth quarter call, that we were somewhat concerned with some of the trends in the first part of the month, but at some point, obviously, they started to really deteriorate in February and March. Can you help us -- walk us through what happened?

### Mitch Fadel - Rent-A-Center Inc - President, COO

Sure. Sure. Be glad to, DeForest. January was about what it expected to be, and February was the month that we were way behind our plan, maybe into the first week or two of March. And then we leveled off, and now for several weeks, maybe the last week of March and the first three of April, or something like that, have been better then the year before. So really, February was the month where, because remember, the income tax money for our customer, historically, comes out right around the first of February. By the first of February we are seeing that money come through the door.

Even the last few days of January, that money comes through the door in earnest. It was February that fell through the floor, if you will. And as March progressed, what we started to see was business getting better from a demand standpoint, but even those sales still weren't coming in. Again, it appears that because the money was three or four weeks later, on average, that people used the money differently than they had historically.

Not all of them. We still had more payouts in a normal quarter, but relative to the year before in the first quarter and relative to our expectations, they were much lower. And it does appear that people did something different with the money when it came in later. Of course, their situation, 30 days after when they were expecting the money, was probably different than it was 30 days, so --. And a lot of them missed 90 days, same-as-cash, from what they rented in the fall. So, the money didn't come in. But, by -- as March progressed, we got back to -- demand started topping last year's level as we got later in March and so far in April.

### DeForest Hinman - Walthausen & Co. - Analyst

I mean, it is interesting. It almost seems like that -- the sales opportunity is gone, to some extent, for the second quarter. But does it also have an impact on customers that do a payout, and then they've been thinking about getting another unit on rent, and then we lost that transaction as well? How many people that do the early payouts turn around and just do a rerun?

### Mitch Fadel - Rent-A-Center Inc - President, COO

That is a great point, DeForest. We run about 50% on the spot re-renting something. Our repeat business overall is between 75% and 80%. So we will get them -- we'll get 75% to 80% back over time. But, within the day or a few days of when they pay out, we are close to 50% on conversions.

So, yes, that is a great observation there. That was part of -- the demand loss was not having the payout, so it became a double whammy. And then, just traffic in general, with people not having that money. So, maybe that is a triple whammy. I don't know, how many whammies --?



### DeForest Hinman - Walthausen & Co. - Analyst

When you spoke about advertising, how do we -- what is the plan to engage the customer and get that back in? Because it seems like that is really going to be a big -- and that is probably the reason behind the guidance reduction. But, how do you reengage the customer and try to get them back in the store?

### Mitch Fadel - Rent-A-Center Inc - President, COO

Well, it is a combination of things. Having the right promotion going on, not just all about putting things on sale, but strategically putting the right things on sale at the right times, having -- getting the message across by having -- we are working on new creative, as well as how do you reach the customer? Different avenues of reaching the customer. TV, direct mail, how do you split that up? Do you spend more on one than the other, based on what we have been spending? How much more do you put towards Hispanic advertising versus non-, and so forth. So, it is a matter of moving the money around, plus changing the creative, and then strategically putting the right promotions out there.

### DeForest Hinman - Walthausen & Co. - Analyst

How should we be thinking about video games going into this year? Is it safe to say those have really been reduced in terms of how much they have been historically? And how should we think about those going into the holidays? Is that a substantial opportunity this year? How are you guys thinking about that?

### Mitch Fadel - Rent-A-Center Inc - President, COO

It has gone down a little bit recently, with the lack of new hardware out there. But, real excited about new hardware coming out later in the year for that to present an opportunity for us. Going back the other way. Hasn't gone down much. It is still a good category for us. But we would anticipate some lift, at least as the year goes on. Later in the year when the new -- couple of new game hardwares come out.

### DeForest Hinman - Walthausen & Co. - Analyst

Do we have any delay on those? Or are we -- can we get those the first launch days, can we have those?

### Mitch Fadel - Rent-A-Center Inc - President, COO

Good question. Still working on that. I don't have an answer yet from our merchandising team, but still working on that. I would not anticipate a delay, but I cannot say that for sure at this point.

### **DeForest Hinman** - Walthausen & Co. - Analyst

Okay. Thank you.

Mitch Fadel - Rent-A-Center Inc - President, COO

Thanks.



### Operator

James Ellman, Ascend Capital.

### James Ellman - Ascend Capital - Analyst

Thanks for taking my question. First, it seems from your comments you just made that you really only had one month that was really weak. Is that fair?

### Mitch Fadel - Rent-A-Center Inc - President, COO

Yes, the early -- the first part of March was also a little weak. But, yes. February was the big problem.

### James Ellman - Ascend Capital - Analyst

All right. And then you have had some recovery since then?

### Mitch Fadel - Rent-A-Center Inc - President, COO

Correct.

### James Ellman - Ascend Capital - Analyst

I guess I'm just trying to understand, if you had basically a 30-day period of weakness, why reduce your guidance by a full 10% from that?

### Mitch Fadel - Rent-A-Center Inc - President, COO

Well, you are talking about a lot of sales income coming out of the business. It is not coming back as in the second quarter. And it is a matter of where the portfolio is. It doesn't matter whether it happens in one month or two months, it is where is the portfolio, relative to where we had anticipated it being at the end of March? And when that is down, plus the revenue already lost in the first quarter, that is what the numbers come out to.

### James Ellman - Ascend Capital - Analyst

Okay. On your comments, earlier you had mentioned that the returns from RAC being resold at Core is causing some cannibalization of the economics of the Core business. How is that impact going to ramp up at Core as you ramp up the number of RAC locations?

### Mitch Fadel - Rent-A-Center Inc - President, COO

I talked about it. It is not a big number yet, if you think about that 30-basis point range. And we have already got over 1,000 of them. So, it is pretty ramped up, RAC Acceptance. It may go a little higher. We certainly need to look at things that can help offset that. But overall, gross profit dollars go up. And if the percentage comes down, that doesn't bother us a whole lot as long as gross profit dollars go up.



### James Ellman - Ascend Capital - Analyst

Okay. But if you had one quarter where, as RAC gets larger, if you had one quarter where the keep rate were to come down and you had more returns, that would likely cause some inventory difficulties at Core, is that fair?

### Mitch Fadel - Rent-A-Center Inc - President, COO

The model works really well right now with the keep rate being in that 70%, 75% range, that is correct.

### James Ellman - Ascend Capital - Analyst

Last question I have is just, do you have any significant agreements coming up for renewal with some of your partners in RAC? And do you expect any changes in pricing when that takes place?

### Mitch Fadel - Rent-A-Center Inc - President, COO

No, we don't anticipate any changes with our current partners in RAC Acceptance.

### James Ellman - Ascend Capital - Analyst

Okay. Do you have any major clients that are -- or any major partners where the agreements are coming up for renewal? If you could just give us an idea of the schedule for that?

### Mitch Fadel - Rent-A-Center Inc - President, COO

No, the agreements are not long. They're not like they are five-year agreements anyhow. They have -- they are agreements that, I think you have six-month out-clauses and things like that. The bottom line for us James, once we are in a retailer and driving traffic, in that our customers, about 50% of our customers come back into that store to pay every month in the RAC Acceptance model, we don't have partners deciding not -- or giving us six months notice for us to leave. We have closed some, but that is primarily because the retailer closed, or there wasn't enough volume for us in those stores. But, once you are in there and you are driving the traffic, and you are driving repeat business, because those customers come into make a payment, the practical side is nobody has ever not renewed the agreement with us. Again, on a per store basis, is there's not enough volume, but not on an overall basis.

### James Ellman - Ascend Capital - Analyst

Okay. Very good. Thanks so much for your time.

### Mitch Fadel - Rent-A-Center Inc - President, COO

Thanks, James.

### Operator

We have no further questions at this time. I will turn the call back over to Mr. Mark Speese.



#### Mark Speese - Rent-A-Center Inc - Chairman & CEO

Thank you, Robert and Mitch. Thank you for your comments. And thank you to all of you for joining us this morning. As we stated, clearly disappointed with our operating results in the first quarter. Having said that, we like what is going on with all of our growth initiatives. We believe the trends that we are seeing of late support what our theory, or thesis, is as it relates to the first quarter's impact.

Having said that, we realize we've got a fair amount of work to do within the Core business. As hopefully you have heard, there are a number of things going on that we believe will drive the desired results and allow us to get back ahead, from a portfolio standpoint, where we were previously. We do feel confident of our ability to be able to do that. Again, as always, we appreciate your interest and support of the Company, and we look forward to reporting back to you next quarter with results that will further support that we've got it on the right track again. So, thank you very much and we will talk to you next quarter.

#### Operator

This concludes today's conference call. You may now disconnect.

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