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RCII - Q2 2012 Rent-A-Center Earnings Conference Call

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OVERVIEW:

RCII reported 1H12 revenue and EPS growth of approx. 10%. 2Q12 total revenues were $749.7m and net earnings (including about $0.08 drag on earnings in 2Q12 due to continued investment and ramp up of international growth initiatives) were $44.2m or $0.74 per diluted share. Expects 2012 total revenues to exceed $3b and diluted EPS (including approximate net $0.25-0.30 drag on EPS primarily relating to international growth initiatives) to be $3.00-3.20.

CORPORATE PARTICIPANTS

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

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

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

Robert Davis *Rent-A-Center - EVP Finance, CFO, Treasurer*

CONFERENCE CALL PARTICIPANTS

T.J. Macondo *Raymond James & Assoc. - Analyst*

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

John Baugh *Stifel Nicolaus - Analyst*

Jason Smith *Canaccord Genuity - Analyst*

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Bill Maffie *Adage Capital Management - Analyst*

John Rowan *Sidoti & Co. - Analyst*

Jon Braatz *Kansas City Capital Assoc. - Analyst*

PRESENTATION

Operator

Good morning and thank you for holding. Welcome to Rent-A-Center's second-quarter 2012 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, July 24, 2012. 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'd now like to turn the conference over to Mr. Carpenter. Please go ahead sir.

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

Thank you Tom. 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 second 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. 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 forecasts, growth in revenues, earnings, operating margins, cash flow, 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 release issued yesterday as well as our annual report on Form 10-K for the year ended December 31, 2011, and our quarterly report on Form 10-Q for the quarter ended March 31, 2012. Rent-A-Center undertakes no obligation to publicly update or revise any forward-looking statements.

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

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

Thank you David. Good morning everyone and thank you for joining us for a review of our second-quarter 2012 results.

Let me begin by saying I am pleased with the overall performance and operating results for the quarter, and I'm also pleased with how we are positioned as we begin the second half of the year. While there continues to be uncertainty in the broader market and while our customer base remains under pressure, the need and demand for our products and services remains steady, and we continue to deliver on our expectations.

As was noted in the press release, our second-quarter revenues increased 7.4%, supported by a same-store sales comp of 2.8% and our earnings per share increased nearly 9%. For the first half of the year, we have achieved both revenue and earnings per share growth of approximately 10%.

As was also noted, we utilized approximately $16.5 million of our cash on hand to repurchase nearly 500,000 shares of our common stock in the quarter. All the while, our balance sheet remains very healthy and is a strength of the Company.

I am especially pleased with the results of the RAC Acceptance business unit. Revenues have nearly doubled year-over-year, and as noted in the segment reporting section of the release, gross profit margins were 58% in the quarter, much like we expected after having been approximately 50% in the first quarter due to the accelerated early purchase options driven by tax refunds, so very much back in line with expectations. And that result, along with the strong revenue growth in RAC Acceptance, led that unit to report operating profits of $7 million in the quarter. So again, very strong performance in RAC Acceptance and those trends are expected to continue. Those results themselves, coupled with the 1.6% revenue growth in the core business and the international initiatives continuing to perform in line with our expectations, allows us to reaffirm our original 2012 guidance. So it was a good quarter, a good first half of the year, and as always, I appreciate the hard work of our associates and coworkers, and we appreciate your support as well.

And with that, I'm going to ask Mitch to provide you some additional commentary on the results. Mitch?

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

Thanks Mark. Good morning everyone.

As Mark mentioned, overall, we are pleased with both our topline and bottom-line results for the quarter. Our same-store sales were 2.8% with the RAC Acceptance impact of 365 comp locations making up about 75% of it and our core business contributing the balance. This now puts our same-store sales at a very strong 4.5% year-to-date with about half of that coming from the core business and half coming from RAC Acceptance on a year-to-date basis.

Overall, our revenue grew 7.4% with the core business growing 1.6%, pretty good numbers considering the recurring revenue challenge we had to overcome with the strong early purchase activity in the first quarter. Also pretty good considering consumer sentiment being what it is in this country.

Our collections metrics remained in line with expectations, and our customer losses in our core business came in at a historically low 2.2%.

Now, you'll notice when our 10-Q is filed later this week our overall losses in dollars are up about $2 million from the same quarter a year ago, primarily the result of our large growth in RAC Acceptance and very much in line with our expectations for that new business.

Our inventory held for rent in our core business came in right on top of last year at 24.6% in the core segment. You'll notice the dollar amount of the on-rent inventory and held-for-rent inventory are both down from last year. We get questioned on that ought, so I wanted to point out that that's due to deflation in electronics, as we actually have more units on rent at the end of June this year than we did last year, so that lower inventory values from deflation. Fortunately, we don't see the same level of deflation in our revenues as we are able to reduce the term of the rental agreement and not the weekly or monthly rates.

Mark mentioned the great growth in our RAC Acceptance segment. Their revenues were almost double what they were in the same quarter last year and their margins are at the anticipated levels. We ended the quarter with 811 kiosks and we should end the year at about 950. As he mentioned, things are going really well for us there.

On the international growth front, we opened 13 more stores with 10 of those being in Mexico. We continue to like what we see out of Mexico and we remain enthused about that 1000-store opportunity. Overall, a good quarter for us in all segments and I'd like to thank our 20,000 coworkers for their tremendous efforts and accomplishments.

Robert?

Robert Davis - *Rent-A-Center - EVP Finance, CFO, Treasurer*

Thank you Mitch. I'm going to spend a few minutes updating everyone on our financial results during the quarter as well as review our 2012 annual guidance, after which time we will open the call to questions.

As a reminder, much of the information that I do provide, whether it's historical results or forecasted results, is going to be presented on a recurring and comparable basis and will therefore exclude any nonrecurring charges.

As outlined in the press release, our total revenues were $749.7 million during the second quarter of 2012, an increase of $51.4 million, or 7.4%, as compared to the second quarter of last year. This increase was primarily due to an increase in revenues within the RAC Acceptance segment leading to our solid same-store sales count. And a bit of a milestone with the completion of the last quarter's revenues for the LTM period ended June 30, 2012, the Company has now exceeded $3 billion in revenue for the first time. So very, very strong topline growth.

Our net earnings in the quarter were $44.2 million while diluted earnings per share equated to $0.74, an increase of 8.8%. These results do include about an $0.08 drag on earnings in the second quarter due to the continued investment and ramp up of our international growth initiatives. As expected, these investments had a similar impact on operating margins in the quarter which were down 70 basis points quarter-over-quarter, and equated to 10.5%, although we did have an overall increase in operating profits.

Similarly, our second-quarter EBITDA increased over 3.6% to $98.8 million and a margin of 13.2%. We generated positive cash flow during the second quarter and year-to-date, we've now generated over $161 million in operating cash flow. During the quarter, the Company, reflecting continued confidence in its strong cash flows by returning cash to stockholders, disbursed $26 million in cash during the quarter between share repurchases and a dividend payment.

Furthermore, we are making our ninth consecutive quarterly dividend payment tomorrow after having reduced indebtedness since June 30 or since quarter end by approximately $33 million. Since the end of the year 2011, we repaid approximately $106 million in indebtedness, which has primarily been a combination of mandatory payments and a reduction in the revolving lines of credit that were outstanding at year-end. We did end the quarter with over $100 million in cash on hand and our leverage ratio at the end of the second quarter equated to 1.45 times, well below our floor on the covenant requirement of 3.25 times. We continue to believe our balance sheet is in extraordinary shape and as such, we believe we do remain well positioned to execute on our growth initiatives and continue to provide long-term value to our shareholders.

Turning to guidance for a moment, based on how we have performed year-to-date, both operationally and financially, we continue to maintain confidence in our annual 2012 guidance. So as a reminder, we expect total revenues to exceed $3 billion by increasing between 7% and 10%. With this projected increase in the topline, we expect our same-store sales for the year to range between a positive 2.5% and 4.5%.

Overall diluted earnings per share for 2012 are expected to be in the range of $3 and $3.20. This does include an approximate net $0.25 to $0.30 drag on EPS primarily relating to our international growth initiatives.

We expect both our consolidated operating and EBITDA margins to decline approximately 50 basis points during 2012, while we continue to invest for growth and for the long-term. Yet we are expecting the dollars will increase in both categories. More specifically, in terms of EBITDA and free cash flow, the Company continues to believe EBITDA will range between $400 million and $420 million and free cash flow to be in the range of $80 million to $100 million.

The guidance that I have provided does not include the potential impact of any repurchases of stock that we may make, changes to future dividends, or material changes to outstanding indebtedness, or additionally the potential impact of acquisitions, dispositions or store closures that may be completed after the date of the press release.

Finally, as a reminder, you can find on our Investor Relations website the unit level economics for our growth initiatives. These will be updated on an annual basis as our segments continue to grow and mature.

I would now like to open the call to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Budd Bugatch, Raymond James.

T.J. Macondo - *Raymond James & Assoc. - Analyst*

Good morning Mark. Good morning Mitch, Robert, David. This is [T. J. Macondo] filling in for Budd. Congratulations on the strong performance and thanks for taking my questions.

Guys, if I wanted to pick at a couple of line items, I was looking at the gross margin in the core business being down another 150 basis points this quarter. I'm just wondering what the drivers there were, sort of speculating -- is there anything to do with some of the RAC Acceptance merchandise coming back into that business at all?

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

This is Mitch. That's a real small part of it. 150 basis points, maybe about 20 basis points, is all that is. That is better than the first quarter. We deal with a lower margin on the early purchase options and those remained above what we anticipated in the second quarter. The tax season is primarily February and March, but we still get a lot of early purchase options in April as well. And so that drove it a little bit or maybe primarily.

As we look at where we're at today, you know, we expect to be back to last year's levels. By the end of the year, by the fourth quarter, we'll be on top of 2011 gross margin levels. We might still have a little bit of a deficit in the third quarter, but by the fourth quarter we should be back on top of it. It's been primarily the early purchase options, a little bit from a promotional activity standpoint but as we look at our promotional calendar this year, I think you'll see by the fourth quarter we are back on top of last year's gross margin numbers quarter-over-quarter.

T.J. Macondo - *Raymond James & Assoc. - Analyst*

Yes, that's exactly what I was looking for, Mitch. And so the 100 basis points of overall contraction for the year in the guidance, that's where you get the confidence because that does imply a bit of a recovery in the back half of the year, and that's what you're -- that's what you're thinking it comes from. Am I correct there?

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

You are correct.

T.J. Macondo - *Raymond James & Assoc. - Analyst*

And last quarter, a question for Robert. Last quarter, I think it was you mentioned to us the seasonality of earnings this year might look a little different than it normally does based on the RAC contribution. So is that still how we ought to be thinking about it with the third-quarter earnings number?

Robert Davis - *Rent-A-Center - EVP Finance, CFO, Treasurer*

I think that's a fair assumption. I think when you think about the way that the quarter came in relative our expectations, as well as consensus, maybe that moderates a little bit from our comments last quarter.

T.J. Macondo - *Raymond James & Assoc. - Analyst*

Okay. Yes. Like I said, excellent performance this quarter, so that's -- to get to $3.20 at the top, that's -- that will be interesting in the fourth quarter I guess.

Robert Davis - *Rent-A-Center - EVP Finance, CFO, Treasurer*

Certainly and -- certainly still a ramp-up, so RAC Acceptance will still add a lot more earnings in the fourth quarter than they did in the third quarter, so we need to keep that in mind as you look at quarterly estimates.

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

Right.

T.J. Macondo - *Raymond James & Assoc. - Analyst*

Then last one for me on the balance sheet, excellent condition, guys. Any additional detail you can offer on what the balance of the outlook for repurchase might look like for the rest of the year?

Robert Davis - *Rent-A-Center - EVP Finance, CFO, Treasurer*

We don't really forecast that in our model or our EPS. That's the comments I was making at the end of the guidance section, but as you know, T.J., we are always very prudent in how we manage cash, looking at opportunistic share repurchases if and when that opportunity presents itself. There's no stated plan other than we have authorization from our Board to purchase up to $800 million. We spent $732 million, so we've got $68 million left. There's no restrictions within our credit agreement, and the indenture, our bond adventure is about double what the levels are left authorized by the Board. So other than mandatory payments, no specific plans other than being opportunistic when and if the time comes.

T.J. Macondo - *Raymond James & Assoc. - Analyst*

Okay guys, thank you again for taking those questions, very helpful. Congratulations again.

Operator

Arvind Bhatia, Sterne Agee.

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

Thank you and good morning guys. Good quarter.

I wanted to talk a little bit more or get your thoughts a little bit more on the core business. Some of the discussions I've had with investors since yesterday, that's something that people want to kind of hear a little bit more about. Obviously, RAC Acceptance was very strong and the margins came right back. But I wonder if you could maybe talk about how you view the core business from this point on. I think, Mark, you mentioned initially the customers challenge, but looking at the RAC Acceptance numbers, one would think that your business there doing really well. So it would be very helpful to get some color on the core business.

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

Let me start with that. This is Mitch. Like I said in my prepared comments, when you think about the year, you've got to look at the year more so than either one quarter because the early purchase options in the first quarter certainly pulled revenue forward. And when we look at the year-to-date comp of 4.5%, that's pretty even between RAC Acceptance and the core business. So to have half of that 4.5% in core business, pretty strong for us. If you look back over the last three or four years, somewhere between 2% and 2.5% in the core business from a same-store sales standpoint is pretty good, especially in this economy I think was Mark's point. So it was only, as I mentioned, 25% of the 2.8% comp in the second quarter, so that's about 0.7%. but again, those early purchase options pulled some revenue forward. We talked about that in the last call that that would be challenging. But yet it's still positive in the second quarter and for the year and are in good shape with it being actually slightly more than half of that 4.5% comp.

So it's steady. It's not -- we don't sit around thinking we're going to grow 5% or 6% in our core mature business. It's a couple of percent growth a year in that business and the growth initiatives, obviously it funds the growth initiatives with its great cash flow and funds RAC Acceptance and international expansion. (multiple speakers)

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

I was just going to comment, Mitch summarized it very well. I think certainly consumer confidence, you know, in the broader markets, is at lows and continues to stay there. And that causes pause. As Mitch said, we continue perform. The demand is there. At the same time we know consumers are under pressure. We know that confidence is at historical lows, if you will, and so you've got to temper that a little bit. And I think that's really what our position is.

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

The other thing I noticed is you did a great job on the cost control side, certainly versus our model. They seem to be good leverage, and with the 0.7% comp the core business, particularly in light of that, this is impressive. So is -- can you maybe provide some color on how sustainable that is and how we should view where there's some one-time things that maybe we weren't thinking about that helped the cost, or we should expect this to continue?

Robert Davis - *Rent-A-Center - EVP Finance, CFO, Treasurer*

I think it's fair to say a couple of years ago, Arvin, when RAC Acceptance was in its infancy and international was sort of a dream on a wall and the core business was challenged, we got very serious about making sure we are able to manage the middle of the P&L, which we focused on the last several years. You are seeing some of that -- the fruits of that labor continue on and on.

I would be remiss not to just comment that obviously the price of gas has helped a little bit, and we expect that to continue based on projections from the Department of Energy. Having said that, there are no one-time items, if you will, but we do have a more disciplined approach and focus around managing all parts of the P&L, from the store level costs to the back-office costs, and that discipline we would expect to continue. So --

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

Definitely very impressive. Last question is on the international side of things. I wanted to see if you can maybe talk about what's going on in Mexico, just maybe some more granularity, what's happening to perhaps the bad debt trends there. Are they within projections? And just overall how should we think about the next two years or so, $0.25 to $0.30 EPS drag this year? Are we thinking 2014 when we start to get close to breakeven, perhaps some color there?

Robert Davis - *Rent-A-Center - EVP Finance, CFO, Treasurer*

I think as, Mitch indicated in the prepared comments, as well as Mark, the international initiatives are in line with our expectations overall. The losses are in line with our expectations, so we look at all parts of the P&L. Things are in line with what we would expect at this point.

Having said that, as we think about the continued ramp, you are right, Arvind. It's not until you get it out to 2014 when you start to see a neutral P&L related to that. So as these stores mature next year, there will be a continued slight drag based on the stores to be opened in the back half of this year, but then the stores we open in '13 will obviously have an impact, so it's not until '14 when you start to see a breakeven from the P&L.

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

That's great, okay.

Robert Davis - *Rent-A-Center - EVP Finance, CFO, Treasurer*

Recognizing that kind of a high-level commentary, we haven't given specific guidance related to '13 or '14, but just with a sort of measured approach to rolling out stores, that's what one could expect.

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

Operationally, Arvind, Robert said it, I know Mitch -- we are pleased with the overall operating results down there. We continue to believe that that market has tremendous opportunity or potential. We continue to say 1000 stores, whatever that exact number, but everything we continue to see reaffirms that the proposition is being embraced and that the market will support it.

And then to Robert's comment, our stated openings over the next couple of years, assuming we stay within those ranges, would imply that it's not until '14. Should we choose to open more because of some reason, that could have an adverse affect and conversely if you did less, but we continue to be pretty bullish and opportunistic about what we are seeing down there.

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

I appreciate it guys. Good luck.

Operator

John Baugh, Stifel Nicolaus.

John Baugh - *Stifel Nicolaus - Analyst*

Thank you and good morning. I'll just jump right in on some questions. I wanted to circle back on the early payout issue, sort of year-to-date if you will, and maybe segment it between the RAC experience and the core experience. Could you first maybe address, because we are in a tough economy and yet people are coming up with all of this money, why that happened this year in terms of early payouts being higher in both, it sounds like both segments?

Robert Davis - *Rent-A-Center - EVP Finance, CFO, Treasurer*

Certainly the tax returns are where the money is coming from. We did see a slowdown in May and June on the yearly purchase options. But it would still be the tax returns, John.

The deflation in electronics can drive some of that in the core business. Remember we reduced the term primarily rather than the rate, so we have shorter terms on electronics than we used to, so that would be part of it. I think the income tax refunds continue to be a little higher every year for the consumer, and it would just be a combination a little bit on deflation, on electronics having shorter terms, and then just the income tax money.

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

The other big driver also, don't lose sight of the fact, we've had several great years now. I say great years, we've grown our business, and you've heard us over the last 10, 12 quarters talk about sequentially and annually comps being out, growth being up, so we've grown the portfolio. If all things remain equal, meaning 75% -- if 25% build to term, you have a much larger base to begin with, so by default you're going to have more payouts.

John Baugh - *Stifel Nicolaus - Analyst*

Okay.

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

So it's not a bad thing, but it does create a headwind that you've got to overcome when you get into the comparable period in the future.

John Baugh - *Stifel Nicolaus - Analyst*

And then maybe focusing back on this gross margin and I'm going to look at the six-month year-to-date versus the quarter, in the core business, I see you're down 100 to 70 basis points. So you are saying maybe 20 or 30 of that is the returned merchandise from RAC coming back into the system, and the rest is, what, spread between early payout impact and promotions? And if so kind of what's that spread?

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

I think certainly about 20 basis points on RAC Acceptance product. The 150 basis points I believe it was in the second quarter, I know the spread would be pretty equal between additional early purchase options and then promotional activity.

Like I said earlier, John, we see ourselves closing that gap in the third quarter and being above -- at or above last year's level during the fourth quarter. So we see us making up that deficit.

John Baugh - *Stifel Nicolaus - Analyst*

Mitch, that's simply because now that early payout declined in May and June, you don't have to be as much promotional?

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

Primarily, yes.

John Baugh - *Stifel Nicolaus - Analyst*

Okay. And then what is happening precisely when you merge a RAC location? I see you've done was it close to 50 year-to-date. Explain physically what's going on there, and then maybe discuss a little bit how much of that is Best Buy or other situations. And then also are you having any wins, new account wins in RAC Acceptance and likewise any departures? Thank you.

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

Sure. In the RAC Acceptance, the activity so far this year in those mergers, yes, certainly the 13 Best Buy kiosks are part of that 47. I think a lot of them were the Roomstore bankruptcy. Those were the primary drivers.

As far as other wins, we are having them every day pretty much adding 200 stores. Regional players, no national players, but we continue to talk to the national players. But yes, adding these 200 stores, we are having wins every month with regional players. But not any national players yet to talk about, though we keep talking to the national players.

John Baugh - *Stifel Nicolaus - Analyst*

And are they still primarily furniture-related, furniture maybe and appliances?

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

There's a few that carry -- we are getting into more that have a mix of product. Badcock's in the Southeast is a mix of product, a couple of others are a mix of product, more like Kahn's portfolio, so it's not all furniture. I would say it's a mix between just furniture and then stores that carry appliances and electronics as well.

John Baugh - *Stifel Nicolaus - Analyst*

And last question, investors seem concerned about the CFPB. I was wondering if you could share with us any discussions you've had with lawmakers or people you speak to to kind of get a feel for what's going on in Washington about whether this new agency is beating a drum to your doorstep on any either of RAC or the core business, or there's no discussion, they've delineated the 90-day term and that's it.

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

While we certainly are mindful of the CFPB, their authority and just legislation generally speaking. And as you might surmise, we spend a fair amount of time staying connected to it. There's nothing today that we've heard that is inconsistent or different with what we have said in the past or what our belief or expectation is for the future, meaning that, again, in its current form and we've said this, that by definition the transaction is excluded, given the parenthetical. And again, there's nothing to indicate at this point in time, we have not heard or seen anything that would be give pause that might suggest that was going to change. So we continue to feel good and believe that's the right outcome anyways.

John Baugh - *Stifel Nicolaus - Analyst*

Thanks and good luck.

Operator

Laura Champine, Canaccord Genuity.

Jason Smith - *Canaccord Genuity - Analyst*

Hi guys. This is Jason Smith. I'm on the line for Laura today. I just had a quick question regarding the RAC Acceptance business. How are the charge-off rates there in RAC Acceptance? How's that tracking compared to the core business?

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

A couple different ways of looking at it. It's in line with our expectations. The amount of charge-offs in the second quarter relative to the amount they have on rent ran lower than the core business. The dollar amount on the P&L won't necessarily be lower because, as the stores grow, the percentage might be higher on their P&L but the actual amount of charge-offs relative to the customer base ran slightly lower than the core business in the second quarter.

Jason Smith - *Canaccord Genuity - Analyst*

Okay. And then another quick question on the kiosks, I know you discussed this a little bit before. Some of those merged kiosks were Best Buy and Rooms To Go. When you look at between the merge and the closed kiosks, are these kiosks that have reached maturity? Where are they along the lines of the store economics Spectrum?

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

Now the closures of Best Buy and Roomstore? First of all --

Jason Smith - *Canaccord Genuity - Analyst*

I'm saying just all the kiosks that you've merged or closed this year so far. I mean if we are looking at this from a modeling perspective, are we losing year five stores, are we losing year two stores, just to get a better idea?

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

Losing primarily underperforming stores, no matter where they are in the cycle. I would just say I thought you said Best Buy and Rooms To Go. It's Roomstore that went into bankruptcy, not Rooms To Go was all I was correcting. But the underperforming stores, almost all of them if not every single one.

Jason Smith - *Canaccord Genuity - Analyst*

And now that the --

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

Best Buy, while we thought Best Buy may have grown larger, they were only six months old. It was a six month test and you can look at our growth -- the model that we have out there. They don't reach maturity until year two. So none of these were even close to those kind of levels.

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

That's a good clarification. Best Buy wasn't underperforming. That was a test (multiple speakers). The other ones --

Mark Speese. That's right.

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

The other 34 I guess would be 47 minus the 13 were all underperforming.

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

Yep.

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

Best Buy wasn't underperforming. It was just early in the test.

Jason Smith - *Canaccord Genuity - Analyst*

And then looking at these 950 kiosks you're forecasting for the year, that includes these closures and mergers?

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

Yes. That's the net number where we will end up.

Jason Smith - *Canaccord Genuity - Analyst*

Great, thank you very much.

Operator

Brad Thomas, KeyBanc Capital Markets.

Brad Thomas - *KeyBanc Capital Markets - Analyst*

Thanks, good morning guys and congratulations on another solid quarter here. Most of my questions have been answered, but just a couple of housekeeping items.

In terms of the guidance, full-year comp of 2.5% to 4.5%, if we look at the run rate year-to-date, then that full-year guidance does imply a pretty wide range for the back half of the year. Should we be thinking of comps in the second half of also being within that range, or are there things that could come up that might knock it down to the lower end?

Robert Davis - *Rent-A-Center - EVP Finance, CFO, Treasurer*

So -- the annual guidance 2.5% to 4.5%, maintaining that guidance and factoring in the fact that year-to-date we are at 4.5%, that would imply that you expect the back half of the year to start to moderate a little bit. Obviously the first-quarter comp of 7.1% had a large impact on the annual comp, so we would expect the third and fourth quarters to be similar to the second quarter.

Brad Thomas - *KeyBanc Capital Markets - Analyst*

Okay, great. And then just a follow-up on the infrastructure that you have in place for RAC Acceptance and international. You've given us obviously the unit economics on those growth vehicles. Where do we stand today in terms of some of the infrastructure? Do you have what you need in order to do growth for the next couple of years, or is it possible we may get some more step-up in those costs above and beyond just the unit economics?

Robert Davis - *Rent-A-Center - EVP Finance, CFO, Treasurer*

We feel like we are sufficiently invested for the near term in both initiatives via RAC Acceptance and international. Not until you get way further out would there be any cause for concern related to additional expenses for infrastructure. Obviously, we've invested on the front end in both initiatives, primarily between back-office in Mexico and middle-management in RAC Acceptance with the growth there. So as we sit here today, we expect no additional step-up charges, if you will, or surprises related to additional costs for those initiatives.

Brad Thomas - *KeyBanc Capital Markets - Analyst*

Great, thanks so much.

Operator

Bill Maffie, Adage Capital Management.

Bill Maffie - *Adage Capital Management - Analyst*

Good morning guys. Thanks for taking my question. I just wanted to ask, if you look at the year-over-year contribution margin or profit flow-through, however you want to phrase it, for the RAC Acceptance business, the revenue grew just a whisker under $40 million. The EBIT grew closer to $15 million.

And I wanted to ask two questions. One, is it safe for us to presume that the contribution from the acquired stores that you bought a couple of years ago didn't really change much year-over-year, so that, in that incremental contribution, it wasn't due to a real change in the acquired stores, it was due to the aging of the Company's own stores?

And the second part of the question is, if that's a reasonable assumption, is do you guys think, when you look at your guidance, second-half revenues from RAC last year were probably in the $110 million to $115 million range. We don't have exact breakdown by quarter. But it looks like the back half of this year, if your guidance of over $300 million still holds, might be $50 million, $60 million more revenue than the back half of last year. So, the second part of the question is do you anticipate sort of a 40% contribution margin on a year-over-year basis for the back half RAC revenue growth as compared to the revenue growth last year -- or rather the revenue base last year?

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

So a lot of questions there. I'll try to take them one at a time. But your first question as it relates to the acquired kiosks from TRS having an impact in the additional incremental income in the quarter relative to the growth in the revenue, I think, for the most part, slightly but not material. I think what you're seeing mostly is the ramp up in the age of the stores as we are continuing to grow the revenue and leveraging the cost structure. That's impact you're seeing.

You are right sort of directionally in regards to the revenue assumption for the third and fourth quarter as it relates to RAC Acceptance, just given the overall annual forecast of over $300 million, what we've achieved year-to-date, so I think your thoughts there are directionally correct.

As it relates to the flow-through of that incremental revenue in the back half of the year, we would expect that flow-through margin to continue to widen as the stores grow and mature. So I think you're on point with all of your questions.

Operator

John Rowan, Sidoti & Company.

John Rowan - *Sidoti & Co. - Analyst*

Quickly on seasonality, I know you guys mentioned that it was going to be slightly different kind of in the middle part of the year on last quarter's conference call. Just to make sure, you're still looking for a step down in EPS between second and third quarter, correct?

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

I think -- where we are year-to-date and what expectations we've given for the year, I think -- it's hard for me just say what we're expecting by quarter because we don't give quarterly guidance. But you think about seasonality, I think the question earlier was how does -- is it moderated more this year relative to past years, just given the ramp up of RAC Acceptance? And the answer is yes, seasonality is moderated more now than it has been historically, but there is still some seasonality.

John Rowan - *Sidoti & Co. - Analyst*

Okay. Fair enough. And then just to turn to Mexico for a minute, I'm curious what you guys are seeing from older stores in Mexico. How are they coming and what are you learning from those stores that are making you bullish on the prospects of getting to 1000 stores in Mexico?

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

What we're seeing is they continue to perform generally in line with our model. Not every single one, but on average and generally speaking they're performing in the -- the ones that are in their second year are performing in line with the second year of our model. So as we've said, we haven't seen anything in the first year or the second year to discourage us. Everything has been just the opposite, and we remain excited about having 1000 stores down there.

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

To get comfortable in terms of the number of stores, the 70 or so that we operate today, I'll remind you we have gone into seven, eight differences distinct markets, some very far in-country. And so we started at the border, but then we, by choice, went in-country. Tampico, Guadalajara, Monterey, San Luis Potosi, with the whole idea that we didn't want to get false-positive reads, if you will, and then extrapolate that into something bigger. So it's really spread around the country a little bit. We are not in Mexico City but, again, we believe that we went into distinct and different BMAs, market states, if you will, that would allow us to test the proposition, test the acceptance of it, the consumer, you know, you think about a little different culture in each one of those. Throughout all of those, we continue to see the kind of results that suggest that this isn't just a border play; t his in fact can run through the country. And then when you take population and all the other stuff, it leads us to believe that yes we can in fact do somewhere in that neighborhood.

John Rowan - *Sidoti & Co. - Analyst*

Okay, fair enough. Then one last question, obviously it seems like there's been a little bit of a diversification for the stores in which we are operating kiosks. Not much, but a little bit of a diversification. Is there any -- has -- the challenges with a lot of electronic retailers, has that changed your negotiating ability, if you will, to try to get kiosks set up in non-furniture stores?

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

It probably has helped our ability to get that up in those stores as they look for ways to add business. Yes, I t think it has probably has helped, John.

John Rowan - *Sidoti & Co. - Analyst*

Okay, fair enough. Thanks a lot.

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

Thank you.

Operator

(Operator Instructions). Jon Braatz, Kansas City Capital.

Jon Braatz - *Kansas City Capital Assoc. - Analyst*

Good morning gentlemen. If we could look ahead a little bit, you've done a good job of returning cash to shareholders in the form of dividends and share repurchases. Can you talk a little bit -- I'm not necessarily asking for guidance, but a little bit about maybe your capital spending plans for next year and then also mandatory debt repayments and then lastly the level of cash taxes versus report taxes for maybe 2013?

Robert Davis - *Rent-A-Center - EVP Finance, CFO, Treasurer*

So when you think about mandatory payments, I think most of you know we turned out a lot of our senior debt a couple of years ago. We've got about $25 million of mandatory repayments on an annual basis for the foreseeable future, but it's not until several years out that some of that comes due in a bullet maturity. Obviously, our subordinated debt is a note that doesn't mature for several years either.

So when you think about debt service, it's primarily the $25 million mandatory payments. We do have a revolver that is drawn that we have the option to reduce the levels within the revolver if we so choose just to provide more dry powder liquidity, that's not saying that's what our focus is on. But obviously, that's an opportunity to reduce indebtedness further beyond the mandatory payments.

The CapEx requirements, they have been higher last couple of years, primarily due to buying the TRS stores. Not that there's a lot of capital improvements there, but we've also been investing in the back office, in technology. I think we've talked about that before.

Our CapEx requirements this year I think we've estimated $105 million, that's down from $130 million or $140 million from last year. And so as we look out beyond this year, we would expect a similar level, maybe slightly less than current levels when you think about '13 and '14. A lot of that is driven by how quickly we ramp up in Mexico, RAC Acceptance to a lesser degree just because the capital requirements there are much smaller. But obviously, depending on how fast you ramp up new stores will impact that.

But as we sit here today, we expect the $100 million-plus this year to be similar next year and forward, maybe slightly less than. And then as you think about share repurchases or dividends, obviously again just being opportunistic there on the share repurchase side, dividends. We have no current plans of changing or altering the dividend rate, but obviously that's always something that we will review as well.

Cash taxes this year estimated at $110 million. I think that was your last question. We expect that to increase next year by $20 million or $30 million roughly. I don't have the specific number in front of me but I think it's going to be disclosed in our 10-Q when we file that later this week. So more to come or more transparency for that, Jon, when we file later this week.

Jon Braatz - *Kansas City Capital Assoc. - Analyst*

Thank you very much.

Operator

There are no further questions at this time.

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

Ladies and gentlemen, as always, we thank you for joining us. We appreciate your support. We remain focused on our business, and we look forward to reporting more to you again after the next quarter. Have a great day.

Operator

This does conclude today's conference call. You may now disconnect.