FINAL TRANSCRIPT

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Event Transcript

RCII - Q1 2003 Rent-A-Center Earnings Conference Call

Event Date/Time: Apr. 29. 2003 / 10:45AM ET
Event Duration: 45 min

OVERVIEW

Company announced 1Q03 total revenues of $566.4m and diluted EPS up 18.3% over the same period last year. The company also offered guidance for 2Q03 EPS in the range of $1.41-1.44 and full year 2003 EPS in the range of $5.80-5.90. Q&A Focus: The effects of the Rentway acquisition, merchandise mix, and the new advertising campaign.

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RCII - Q1 2003 Rent-A-Center Earnings Conference Call

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Joe Feldman
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PRESENTATION

Operator

Good morning. And thank you for holding. Welcome to the Rent-A-Center first quarter, 2003 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. If you have a question, you will need to press star 1 on your push-button phone.

As a reminder, this conference is being recorded Tuesday, April 29th, 2003. Your speakers for today are Mr. Mark Speese, Chairman and Chief Executive Officer of Rent-A-Center. Mr. Mitch Fadel, President and Chief Operating Officer. Mr. Robert Davis, Chief Financial Officer and Mr. David Carpenter, Director of Investor Relations. I will now like to turn the call over to Mr. Carpenter. Please go ahead, sir.

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

Thank you. 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 significant operational and financial achievements that we made in the first quarter of 2003. If, for some reason, you did not receive a copy of our release or any of the press conferences from the past week, you can download them at our website at investor.rentacenter.com. Also the nongap financial measures to the comparable gap measure. The reconciliation of EBITDA is there.

In addition, certain financial and statistical information that will be discussed during the conference call will also be provided on the same website. Also, I am asking for your patience on the call today, as we attempt to coordinate our communication from two locations. Mark and Robert are in New York, attending the Lehman brothers conference while Mitch and I are in the corporate office here in Dallas.

Finally, I must remind you that some of the statements made in this call, such as forecast, growth in revenue, earnings and operating cash flow and profitability, and other business or trend information or forward-looking statements, these matters are, of course, subject to many factors and different results materially from expectations reflected in the forward-looking statements. These factors are described in our most recent annual report form 10-k, for the year ended December 31, 2002. And our quarterly report form 10-Q for the as filed with the SEC. Rent-A-Center undertakes no obligation to publicly update or revise any forward-looking statements. I'd now like to turn the conference call over to Mark.

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

Thank you, David. Good morning, everyone. As David said, we certainly appreciate your time and interest in joining the company today. I think most of you know and can appreciate it's been a very busy first quarter for us. And even busier last couple of weeks. I think as most of you know, the company has announced several things or transactions, if you will, over this past week, not the least of which was another very strong quarter. And that has been supported by the strong comps, the total revenue growth that we enjoyed during the quarter, our earnings and significant cash flow.

As you also know, the company has announced a recapitalization of our debt and equity structure. This includes notes and replacing them with a new, high-yield issue. In addition, a new bank facility, terming out the existing debtness terming -- of liquidity as well as a share repurchase that will be offered in the form of a dutch tender offer. All of these are taking place simultaneously in various stages and we expect to complete these

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over the next 30 to 45 dis. As Dave mentioned, Robert and I are in New York. We are involved in the Lehman conference. But we are also working on the recapitalization, banking and so forth. I am going to let Mitch and Robert give you more detail. But let me summarize.

I am very pleased with where the company is today, how we're performing, another strong record quarter for the company. The current environment remains very positive. The rent way acquisition, which Mitch will speak to a lot of detail, but has been fully integrated. We are on plan with the results that we expected to achieve, and more importantly, I believe that we're positioned to continue to enjoy continued growth as we go forward. And I say that in the context of our new store expansion plans, as well as other opportunistic acquisitions , again, I view the rent way traction as being completed.

There are certainly enhancements we expect to make over the next 12 to 18 months. But fundamentally, the company is in position to continue its growth initiatives, and I believe there are significant opportunities still available for us on that front. So all in all, been very busy. A lot of good things going on. Very pleased with how the company is performing and where we are today. Let me go ahead and turn it over to Mitch to give you a little more finer detail on the operation side.

Mitchell Fadel - *Rent-A-Center - President*

Thanks, Mark. Obviously we are pleased with our first quarter results. In order to explain our growth numbers, let me start out by saying we have six main levers of recurring growth. Let me remind you what they are. Number one, acquisitions of stores, number two, account bias from a competitor, where we just buy the accounts and take the revenue but not the store. The store closes and we get the accounts. Three, new store openings, merchandise mix, agreements per customer and customer growth.

The first I mentioned was acquisition of stores. As Mark mentioned, we completed the acquisition of stores, 119 of which we kept open. And 196 which we consolidated the accounts into our stores. There were a few capital improvements, few permit signs. And our projection, as Mark had mentioned, first of all, what they were, to be neutral in the first quarter, four, five, and six cents respectively to the rest of 2003. And as Mark mentioned, it's gone very well and in fact, we're running right on our performance projections.

Now, the accretion of this deal runs over time as we implement our business model. Our business model consistently grows with our expanded, local and national programs. And tighter collection programs all coming together with an industry leading compensation program. And although the rent way acquisition was larger than our everyday acquisition, that acquisition front remains a tremendous growth vehicle for us. Not including the larger rent way acquisition, we purchased 90 stores per year in the last couple of years as part of our growth program. And everything we see today as far as market fragmentation and so forth tells us this is a sustainable growth area for us.

.Second I mentioned is the account bias from competitors This is where we add minimal expense to our existing store. These are highly accretive deals. In the last couple of years, not including the rentway acquisition, we have about 110 account buys per year. You won't ever see them in our account numbers, due to the fact that when we buy accounts, that is stiff full quarter with those accounts. These can be normally purchased at six to eight times the monthly revenue of the competitor. And we have very little additional expense to run the already existing store. Again, everything we see today tells us that this also is a sustainable growth area for us.

The third lever I mentioned is new store openings. We opened 20 in the first quarter as we head toward our guidance of 80 for the year. Last quarter, I went into great detail about how or new stores are performing well ahead of the new store model. And this trend has continued. Let me put this in perspective from a growth standpoint. Late fall 2002 or 2001, there's about 105 in the first group we opened. They'll add about 20 cents of DPS this year and about 26 cents next year. These are offsetting the more recent new store openings, because they're in their initiate dilutive stages. So again, another growth that is doing very well. And allowing this plan to continue for as far as we can see.

Now, the last three levers of growth all roll into our account numbers. Merchandise mix, agreements per customer, and customer growth all combine to make up our account number. In the first quarter, our comps were 6.2% against a guidance number of 2.4. As stated in the press release, our sales in early purchase options were much stronger than anticipated. Those always increase in the first quarter of the year. But it was even stronger than in prior years. Now, these stronger sales and early-purchase options, epos, we call them, translated to about 2.4% of the comp, leaving us at 3.8% on the recurring fee rental. Still on the high end of guidance. The 3.8% breaks down as follows. About half from our merchandise mix moving higher. This is a consumer-driven move, ie, high-definition TVs, versus analogs, et cetera. Very strong mix numbers. And something

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we believe will continue as these new products become more prevalent.

The other half of the 3.8% were increased agreements on rent. Our customer growth in our comp stores was about .4%, but the agreements went up almost 2 percent. Another way to look at this is our average customer has gone from 1.54 agreement on rent to 1.56. It is about half mix and half agreements on rent with our customer growth number doubling from its .2 number last quarter. Also, as you know, our new stores are not in our comps until our fifth new quarter. In those cases our current stores may lose to the store due to its convenience for that customer. The convenience stays in the comp. That negatively affects the comp. It's not like we're overcannibalizing or anything like that. But even a few customers going in the store is affecting our overall customer account by 1 to 1.5%. Bottom line is our comps are very strong, each though we take a conservative approach to what is in and not in the comp base.

We have six levers of growth and we're running full throttle on five of the six. Our acquisition remains strong. Account bias is an extremely accretive growth method. Our new store plan is going very well. Our merchandise mix continues to trend upwards and agreements for customers steady and even up a little. And on the customer growth in mature stores, we are pleased it trended up last year from .2 to .4, and we continue to work on programs to increase that, including a new advertising campaign that we just rolled out on April 1st. The new advertising plan goes away from a celebrity spokesperson and towards an everyday customer who tells our rental story. We have also very much improved our Hispanic advertising campaign with our whole new version. And we are can excited about the rollout of English and Hispanic advertising campaigns.

Let me sum it up this way, we have multiple growth drivers. And I've just updated you on how all six are doing. In fact, with all running at current pace, we're at long term 6 to 10% and without any of them getting better. Acceleration to that would just make our growth story even more compelling. One of the points I want to discuss is our collections. Weekly collections continue to be very consistent. Many of you know that we have a standard of 6.5% or less of our customers past due one day or more at the end of the week. We continue to achieve that number or even a little better on a consistent basis. So things have been very good on the collections front. With that, I'll turn it over to Robert.

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

Mitch, thank you very much. I'm now going to provide detailed financial information. And after my comments, at that point, we'll be able to take some questions. Again, starting with the top line, total revenue increased $67.8 million 13.6% to $566.4 million during the first quarter of 2003 as compared to 2002. This revenue growth was driven by revenue from new and acquired stores as well as growth in our same-store sales of 6.2% as outlined by Mitch previously.

In terms of Rentway, it approximated the $14 million. Without that, it equated to approximately 11%. As a result, our net earnings grew 17%. And diluted earnings per share increased 18.3% over the first quarter of the prior year. Again, speaks to the leverage and flow-through in our business model. EBITDA for the quarter equated for 109.3 million for a margin of 19.3%, as compared to a margin of 19.8% for the prior year. However, when you exclude the impact of the acquired rentway, it increased 50 basis points to 20.3%.

As we have outline the before, we expect this margin to remain relatively flat to slightly up for all of 2003 as a result of our new store campaign. In which we anticipate opening 80 new stores this year. Which as you know is a drag on profitability their first year. But as part of our overall strategy to grow earnings 10 to 15% for the long term. I think Mitch gave you some indication of how the new stores that were originally opened, the 105 have been adding to the EPS and again speaks to the viability of our long-term growth story. Our ability to offset this drag on earnings and profitability from our new stores speaks again to leverage and flow-through. Also from an EBITDA perspective translates into a significant cash flow.

From cash flow, the company generated $125 million in operating cash flow during the first quarter. This enabled us to fund the entire Rentway acquisition with cash on hand. We also utilized our cash flow in the first quarter to repurchase approximately 276,000 shares of our outstanding common stock for approximately $13.5 million. In addition, we hung around $9 .5 million in Cap Ex for the quarter and our leverage equated to 1.22 times. In less than half a turn once the capitalization program outlined earlier is complete to around 1.66 times.

Meanwhile, our fixed charges are reduced as a result of the current interest rate environment. In fact, the conservative nature with which we manage our business and our balance sheet is beginning to be reflected in our ratings with S&P and Moody's with the recent change in outlook and entities. It will allow us to lower the cost of capital and flexibility by terming out our

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existing debtness. And from a discretionary standpoint, exclusion one-time charges associated with the recapitalization program, we expect to benefit 30 cents in diluted earnings per share in 2003 and approximately 52 cents for all of 2004 or about 13 cents per quarter.

Let me break out what I expect some of those one-time charges to be, as outlined in the press release of about $40.2 million. There's obviously a tinder premium that we'll be paying as it relates to the existing tendering subordinating notes of about $20.4 million million. Writing out the unamortized fees of about $5 million. And writing off the unamortized fees in our current senior subordinating note structure of about $7.2 million. As well as unwinding our interest rate swaps that we have been under water in, as you know, of about $6.7 million, as well as about $1 million in fees associated with tindering the bonds and tindering the outstanding common stock. Now, obviously these guidance numbers and these recurring -- or this nonrecurring charges are predicated on full subscription in the high-yield tinder as well as full subscription in the equity tinder. Those are not 100% subscribed. These numbers that I'm talking about in terms of accretion may be different, although not materially.

In terms of guidance for the second quarter of 2003, we anticipate total revenue to be in the range of $549 million and $554 million, same store sales of 2 to 4% and diluted earnings per share of $1.41 to $1.44. Full year ending December 31, 2003, total earnings are expected to be in the range of 2.2 billion and 2.25 billion in diluted earnings per share between 5.80 and 5.90. This guidance is after the new-store initiatives, but before the impact of further acquisitions or account buys that may occur after April 28, 2003. With this financial update and other comments, we'd now like to open the call up to questions at this point.

QUESTIONS AND ANSWERS

Operator

At this time, I would like to remind everyone, if you would like to ask a question, please press star then the number 1 on your telephone keypad. We'll pause for just a moment to compile the Q&A roster. First question comes from Travis Hassrow Stevenson Corporation.

Dennis Telzrow - *Stevenson Corporation - Analyst*

Two quick questions. One on the merchandise sales side. Obviously it was a great number. Was there anything you did this year that was different that seemed to bring people in? Or was there incentive on early buys?

Mitchell Fadel - *Rent-A-Center - President*

No. No, there wasn't. Dennis, this is Mitch. There wasn't anything different. We didn't [INAUDIBLE] any more so than any prior years.

Dennis Telzrow - *Stevenson Corporation - Analyst*

Okay. And one other question. I think I sort of probably know the answer. But idle inventory went up a fir amount. Is that relates probably to the rentway acquisition?

Mitchell Fadel - *Rent-A-Center - President*

I'd say that's a big part of it. I think there's two things. Last year, when you compare quarter over quarter, I guess, what you're comparing, we were very low on inventory, actually too low. I don't have it in front of us. It was like 17%% versus our inventory dollars was way too low for us. You know we like to stay around 20%. This year, the 19.5% is more in line with where we ought to be. And that was related to the Rentway acquisition.

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

You heard us talk operationally that we tried to maintain 160 pieces of idle at any given time. And to Mitch's point, in Q1 of last year, we actually entered the quarter with approximately 135 or 137 pieces to Mitch's point, too low. In fact, this quarter, we ended nearly right on that 160 objective, which translates to the 19%. So timing more than anything.

Dennis Telzrow - *Stevenson Corporation - Analyst*

Thanks a lot. Appreciate it.

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

You bet.

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Operator

Your next question comes from Arvind Bhatia with Southwest Security.

Arvind Bhatia - *Southwest Security - Analyst*

Good morning, guys. Can you hear me?

Mitchell Fadel - *Rent-A-Center - President*

Yes. Good morning.

Arvind Bhatia - *Southwest Security - Analyst*

Just quickly, the 176 stores, the Rentway stores that were merged, can you guys tell us if that had a positive, negative, or a neutral impact, you know, as you took out the 176 Rent-A-Center stores from your comp base? And what is the number of stores in the comp base right now?

Mitchell Fadel - *Rent-A-Center - President*

I have a couple of answers. And I'll start. If if I understood the question right, certainly the 176 stores where we just bought the accounts had a positive impact. Those are -- were accretive. And keeping the 119 open, our dilutive at first until we grow them, based on the revenue they're doing. So those kind of offset each other in the first quarter.

Arvind Bhatia - *Southwest Security - Analyst*

What I meant is you took 176 Rentway stores and merged them with your Rent-A-Center stores, right?

Mitchell Fadel - *Rent-A-Center - President*

Right.

Arvind Bhatia - *Southwest Security - Analyst*

And those stores that you merged them with, those you took out of your comps, right?

Mitchell Fadel - *Rent-A-Center - President*

Right.

Arvind Bhatia - *Southwest Security - Analyst*

Those Rent-A-Center were still in the comp, what would, you know, taking them out of the comp had some kind of impact on your same-store sales. Just trying to determine was there a positive impact on -- to that or negative?

Mitchell Fadel - *Rent-A-Center - President*

I would say, Arvind, it was by and large neutral.

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

There's 1,932 stores in the comp currently.

Mitchell Fadel - *Rent-A-Center - President*

Okay. So there wee 176 that were pulled out that might otherwise had been in there had it not been for the consolidation of Rentway. And I don't -- and Robert, if my numbers -- I don't think those 176, had they not gotten the benefit of the account buy and remained in the comp that they would have had any material movement, not one way or the other on that comp number of the 1932. Is that what you're asking?

Arvind Bhatia - *Southwest Security - Analyst*

Yeah. I think. I guess my sense is that the stores that you merged with the Rentway stores, would those tend to be conceptually underperforming stores? Or that's not the way you look at it? It just depends on the market.

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

Not in all cases. And I think your point, which is a valid one. This average Rentway store was doing oh, in the neighborhood of $30,000 a month, or perhaps a little less than that, more often than not, it went into a Rent-A-Center store that was by definition maybe less than the 75,000 a month rent on average. We talked about is we don't take two very good-performing stores and put them together. But we certainly had cases where they went into a very mature Rent-A-Center store because of the same proximity. It was a little across the board. But I think the short answer is those 176, whether they were in there or not would not have materially at all changed the reported comp. It might have been a little higher than what was reported because they were a little less than average, I guess.

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Arvind Bhatia - *Southwest Security - Analyst*

Right. Right. Got it.

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

It might have been a little higher. I don't want to give us too much credit, frankly.

Arvind Bhatia - *Southwest Security - Analyst*

Okay. And then, Mitch, you made the point about the traffic, et cetera. Can you go over those details one more time? I think you said 3.8% is what you're using as a recurring same-store sales number for the first quarter.

Mitchell Fadel - *Rent-A-Center - President*

That's correct. When you take the sales part out quarter over quarter, the sales increase part from the early purchase options and so forth. You take that out and get recurring revenue comp.

Arvind Bhatia - *Southwest Security - Analyst*

And the traffic is about .4. And the rest is pricing and the pricing 3.4% roughly, you were providing a breakdown of that. And I think I missed that part.

Mitchell Fadel - *Rent-A-Center - President*

The 3.8% breaks down half mix, you know. Consumer drink mix, where the consumer is picking the higher-end -- driven mix. Where the consumer is picking the higher-end products. And the average per customer went up from 1.54 to 1.56. Then I guess within that half, if you want to take half and say it's agreements on rent, you can break that down further to a .4% being customer driven. So I guess you could take 3.8 and take 1.9 on mix and 1.5 on agreement increase with our current customer and .4 on customer might be the simple lest way to break that down.

Arvind Bhatia - *Southwest Security - Analyst*

Got it. And then I think the last conference call, we talked about a midpoint of 2 to 4%. So let's use 3% for June quarter that maybe half of that would come from, you know, new customer growth -- or customer growth. You think we could still be seeing those kinds of numbers? Or, you know, since you did show progress, we should sort of expect that progress but maybe not to the extent of 1 1/2%, but maybe somewhere in the midway of .4 and 1%. You know, what do you look at when you think about the customer traffic trends for June?

Mitchell Fadel - *Rent-A-Center - President*

Yeah, we certainly -- I think we said in the last conference call, we'd like to get that customer number back up to comp. And I don't know that we'll get there in the second quarter. I think I said that, you know, by summertime, you know, we went be there -- wouldn't be there any sooner than summertime. Second or third quarter I think, is the -- quarter, I think, is the soonest we'll get there. Of half and half. Obviously it has to do with our advertising campaign.

Again, as I pointed out, we got -- what I was trying to point out is that even if the current customer numbers, you know, how well the revenue grows with all our other revenue growth levers. And the one we're not 100% satisfied is that customer account number. And we'll work on it every day. Whether it will be half or not by the end of the second quarter. I don't know. I don't think it will be at least until the second quarter. And that's really more of an internal goal more than the fact that I can guarantee it like that.

Arvind Bhatia - *Southwest Security - Analyst*

I understand that. But as the comparisons also get easier, I think in the June quarter, you're looking alt more like a 1.6% comparison from last year, versus 3% in March. I imagine that will play into the June quarter as well.

Mitchell Fadel - *Rent-A-Center - President*

Well, both the second and the third quarters, the ending September quarter, yeah, they get a little easier for sure.

Arvind Bhatia - *Southwest Security - Analyst*

Last question. And then I'll let somebody else ask questions. You talked about the mixed change. Can you -- do you have a sense of what percentage of your revenues was high-definition TVs? And as far as the analog TVs are concerned? Are you doing anything special? I know you stopped buying analogs, starting April 1. But are you doing anything different to get rid of those

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analog TVs faster or are you going to let them run their normal course?

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

I don't have the percentage in front of me. No they're just running their course. They're still renting fine. It's not like they're sitting around because they are less expensive than the HDTV's. We're trending more towards the HDTV's, but we're not seeing the analogs sit around either.

Arvind Bhatia - *Southwest Security - Analyst*

Got it.

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

I think you can appreciate we have most on hand, the analog. On the go-forward we're introducing the HDTV. But there's very few stations or signals that the are sent out. And for the extra couple of dollars, obviously we're having traction going forward. But we're not having any problem. It still goes through the vast majority of it and will go through the normal life cycle. Back on that customer comp. Let me just add and as Mitch alluded, we're always looking at advertising.

And as he alluded, there's multiple drivers here. Whether it's a kept-open store or consolidated store, you know, we have that customer base in our network. We don't get credit for it because it doesn't come into the comp until five quarters out. So we don't get credit for it on the front end. But I would argue the that we now have the customer. There's a smaller pool of customers to draw from in that area anyway. The point forward, personally, with all of those other growth drivers hitting the way they are, to us, it's very positive and encouraging.

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

To that point, Mark, as I mentioned in my prepared comments, you know, the account buys translates to 1 1/2 to 2% more customer growth anyhow.

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

That's right.

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

As well as new stores with little bit of overlap there is when we hope -- open one is another 1 to 1.5%. So you're going up in real customer growth.

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

That's right.

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

And the new stores, you're going to have a little overlap. If we have a store with 400 customers, which is about our average, and we put a store three miles away and that store goes down 10 customers and grows back up to 400 over the next couple of years, and we have two stores with 400 customers, three years later, that's a win. And we're doing that all over the country. To try to put stores in, where we're not going to lose even one customer, that the new store might be more convenient for them than the existing source, you think about that, you wouldn't be putting them close enough together.

If you had to put them to the point where you had to take one customer out of the current existing source in the comp, you probably put them too far apart. You probably have a gap in between. If you put the right distance, they'll probably lose 10 customers. Because the new store is not in the comp, negates it. So we're looking at 2 1/2 to 3 1/2 when we add those in. We're at 3 to 4% customer growth with the way we're growing this company. We don't get too hung up on the points guard. Although, do we want to grow that? Sure. Yep.

Arvind Bhatia - *Southwest Security - Analyst*

I agree. I think it's a strong number. Especially with this economy. Congratulations.

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

Thank you.

Arvind Bhatia - *Southwest Security - Analyst*

Thanks.

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Operator

Your next question comes from Joe Feldman from Bear Stearns.

Joe Feldman - *Bear Stearns - Analyst*

Hi, guys. Congratulations on the quarter.

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

Good morning, Joe.

Joe Feldman - *Bear Stearns - Analyst*

Couple of quick questions. One is, given the greater number of early purchase sales, what is -- what kind of impact does that have on future periods, like the second or third quarter? Do people still come back and rent something else? Do they go away for a little while and come back when they need something maybe in the fourth quarter? Any trends you can speak to there?

Mitchell Fadel - *Rent-A-Center - President*

That's a good question. I'll take it first, Mark. That's a good question. If that many people are paying out, then what's the revenue stream. Fortunately, we're able to replace most of those customers, the ones that left. The majority rent something else from us. Either the day they pay out or within 90 days. And then moreover a longer term. So we just -- they buy it -- auto majority buy out what they have. We give them incentive to rent something else. Maybe on a new product. So the ones that don't rerent right away, we obviously replace them because we still feel good about our guidance in the second quarter. It's a challenge in the second quarter. It's an excellent point. But we were pretty successful in replacing all those paid outs.

Joe Feldman - *Bear Stearns - Analyst*

Got it.

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

Mitch is right. And frankly, Joe, like last year was a similar event. And again, it happens to first quarter of every year. But, you know, fundamentally, this year, albeit the numbers were a little greater, of course, the base of stores was larger also. On a relative basis, it might have been up a little bit. But essentially, we've seen the same kind of behavior. A large majority of them, typically within 30 days coming right back into another agreement. Or in many cases, they already had another active agreement. So we still have the customer there. And be it this month or next month, yeah, they just kind of come back in and pick up another one.

Joe Feldman - *Bear Stearns - Analyst*

Got it.

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

Our outlook hasn't changed. Hence the continued guidance 2 to 4% and so forth.

Joe Feldman - *Bear Stearns - Analyst*

Okay. Another question, if you could talk maybe a bit about the advertising change. I know John Madden was pretty successful as a spokesperson for you guys. And you know, what went into that changed to I guess not renew that campaign?

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

Yeah, there were really a couple of things. And as you know, or most of you may know, John Madden started with the company tree years ago. It was at that time for the first time that the company began national television advertising. And given our size and the marketplace and then being in all 50 states after the phone Americas acquisition, it was, you know, in our view, we wanted to get out and really enhance the proposition, if you will, rent-to-own. And certainly the brand-names, specifically Rent-A-Center. It was a very successful campaign.

Over the first couple of years. We saw, and obviously the results speak to it. Enhancements and improvements from comps and growth. And like many campaigns, there's a life cycle. And the fact of the matter is over the last year, that began to deteriorate. We're able to track the volume of calls. There's a dedicated 800 number that's used for all of that advertising. We can measure again response to those ads and so forth. And knowing that his contract was coming up the end of the first quarter, March of this year, about 6 months ago, or maybe even longer, we began evaluating that campaign and specifically and then started developing some comparables. And through all of our diligence, we went out and did mall intercepts.3 Put together a couple of campaigns, including him on a go-forward basis.

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And as we scored them and tested them and so forth, it was very apparent that while he served us very well, that it was beginning to lose some of its value and that we felt we needed to -- that we did a good job in heightening awareness on proposition in the brand name. What we need to do now is a call to action. And this new campaign is really driven more along that type of a scenario, where we think somebody that -- all of our customers can relate to a-little more sense of urgency, if you will, that call to action. And whatnot. And so again, after careful consideration and a lot of studies and so forth, we made that decision. And that was all effective April 1.

Joe Feldman - *Bear Stearns - Analyst*

Got it. And the one last thing before I go, just on the GNA of rental merchandise, it picked up a little bit higher than I guess I was expecting in the first quarter. And I know that, you know, the fourth quarter had also picked up. Any reason that that has gone up a little bit that you can speak to? Is it -- I know the mix is usually about the same margin for most of your products. But is there anything there with mix or...

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

Yeah, Joe, this is Robert. I'll take that question. In the first quarter the depreciation of merchandise as a percent of rental and fees was about 21 .6% and up from 21.4% in the fourth quarter. There's a couple of things going on there. One of which is, as you guys know, some of the pricing and term changes as well as the depreciation on computers that we made conscious decisions to do in the fall of '01 is beginning to get to a point now where it's plateauing and will not have the impact that it had in previous quarters. But the other big thing going on there is the Rentway acquisition.

Those stores are, in general, brought over at existing contract terms there Rentway had in place, in terms of the pricing as well as the term of the contract. And as most everyone knows, Rent-A-Center generally has higher-end products and therefore has higher revenue streams and as a result the depreciation from the Rentway stores is a little higher than Rent-A-Center on average. And so that's the impact going on there in the first quarter.

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

Some of it also, Robert and Joe, would be just the purchasing power difference. When we take their contract and the layer in -- a significant number of contracts into ours so it had an impact. Everyday acquisitions don't when you add a couple of stores. But that number added in a couple of margins because the purchasing power difference will be part of that. So we certainly see it leveling from here, though.

Joe Feldman - *Bear Stearns - Analyst*

Great. Thanks, guys. And good luck in the next quarter.

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

Thanks, Joe.

Operator

Your next question comes from John Brinmitch from Brickola Capital.

Don Emmerich - *Brickola Capital - Analyst*

Hi, guys.

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

Hi.

Don Emmerich - *Brickola Capital - Analyst*

First of all, excellent management of operations is matched by your allocation of capital, and you're adding just as much value there as you are running the business. And that's really great to see. The question I have is the average shares for the year on your 2003 estimate. I mean, the share estimate, 34 1/2 to 35, Robert, that's an average for the year, right?

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

That's correct.

Don Emmerich - *Brickola Capital - Analyst*

And year end would be closer to 33 1/2 or so?

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

That's correct.

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

That's correct.

Don Emmerich - *Brickola Capital - Analyst*

Right. And big cash flow -- from operations. Is it too early to visit the free cash fro?p

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

It is too early, John. Because you can't take the cash flow and analyze it. One is the amount of cash sales that are above and beyond the normalized cash sales in the outquarters obviously translates into additional cash that you don't necessarily have in the outquarters. But the other component is the fact that estimated tax payments to the government aren't daw, you know -- due, you know, until April.

Don Emmerich - *Brickola Capital - Analyst*

Right.

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

There's about a $40 million benefit, maybe 30 million in the first quarter because we didn't have to make the estimated tax payment.

Don Emmerich - *Brickola Capital - Analyst*

Thanks for the clarification. Keep it up.

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

Thanks, John.

Operator

Your next question comes from Karen Miller from Bear Stearns.

Karen Miller - *Bear Stearns - Analyst*

Good morning. I have a question regarding your EBITDA margin. I'm wondering if you could isolate how when you exclude your Rentway acquisition, your EBITDA margin looks better. If you just take a look at the financial statements and your press release, it looks like your cost of merchandise sold went up. And that would make sense, given the fact that there is a shift in the mix towards the higher, you know, more expensive higher-end merchandise. I'm wondering in -- if you could give us more detail on your EBITDA margin.

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

Sure. Essentially, Rentway added about 14 million in revenue. And as we said all along, those stores are neutral in the first quarter. Therefore, there is about $14 million in cost associated with that revenue. So when you take the revenue and the cost, essentially EBITDA does not change. But revenues go down by 14 million. And that's one of the margins -- why the margin is actually 20.3 when you back out the Rentway impact.

Karen Miller - *Bear Stearns - Analyst*

Why are they neutral, then, when you first acquire them? Could you go over that, please?

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

Yeah, as we've outlined before, the Rentway transaction, as most folks know, the 176 stores that we merged into existing Rent-A-Center locations are profitable because we're taking existing revenue stream. We have some incremental expense associated with those in terms of additional employee, additional service, and so forth. But they are -- forth. But they are profitable. On the flip side, the 119 stores that we kept open are, by nature dilutive. We have a cost structure that equates to about 42,000 to break even. Those stores are averaging in the 35 to 37,000-dollar-a month range. And and so the 119 stores are dilutive. However, those are being offset by the 176 stores in neutral in the first quarter. And obviously when we get out to the outperiods and start improving the stores and maintaining the operations in the 176, it begins to become accretive. 4 cents in the second quarter. 5 and 6 throughout the rest of the year.

Karen Miller - *Bear Stearns - Analyst*

Great. Thanks. And one more question. I notice in your income statement you have a line installment sales?

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

It is associated with our [INAUDIBLE] get it now in the state Wisconsin. Again, late last fall, we settled an outstanding litigation issue. I will remind thaw Wisconsin does not have a rent to own law, so it is left up to interpretation. So agreeing in the form of a settlement with the attorney general to change the form of our transaction. We no longer operate rent-to of had o-own stores in -- rent-to-own stores. They are now buy here, pay here in installment stores. As such, those stores are showing the full revenue at the time of sale in Wisconsin.

Karen Miller - *Bear Stearns - Analyst*

Okay. They thinks very much.

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

Thank -- thanks very much.

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

Thanks, Karen.

Operator

At this time, I would like to remind everyone, if you would like to ask a question, please press star 1 our -- your telephone keypad. At this time, there are no further questions. Gentlemen, are there any closing remarks?

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

Folks, again, we'd like to thank you as always for your time and interest in the company. Obviously we've got an awful lot going on. But we're very excited and we're anxious to go ahead and complete and continue delivering the results that we have. So thanks for joining us. And as always, we're available for any follow-up questions there may be.

Operator

Thank you for participating in today's conference call. You may now disconnect.

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