FINAL TRANSCRIPT

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RCII - Q2 2008 Rent-A-Center Earnings Conference Call

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PRESENTATION

Operator

Good morning and thank you for holding. Welcome to Rent-A-Center's second-quarter 2008 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 29, 2008. 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 - Investor Relations*

Thank you, Tracy. 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 regarding 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 release issued yesterday, as well as our most recent quarterly report on Form 10-Q for the quarter ended March 31, 2008. 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 Mitch. Mitch?

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

Thanks, Dave. Good morning, everyone, and thanks for joining us on our second quarter earnings call. It was a very good quarter for us, despite the difficult economic environment. We were within our guidance on store rental and fee revenue and our earning per share, and we exceeded our guidance on same-store sales. We also exceeded our guidance on total revenue, primarily due to the revenue generated from our dPi business unit that we acquired as part of the Rent Way acquisition in late 2006, and Robert will discuss this portion of our business further in his comments.

From an operations standpoint, as I said, the 0.9% same-store sales number was above our guidance, as we benefited from a slight uptick in merchandise sales from the tax stimulus checks. As you'll recall we talked about -- we've talked about a few times, we had a well thought-out marketing plan around the tax checks in terms of converting those who used the money to pay out an agreement, as well as to get new or inactive customers into our stores. We believe that did help the quarter, and while the mail-out of those checks is substantially over traffic is still holding up pretty well as we move through July.

Now going forward we believe we have the right advertising and marketing plans in place to drive the business this summer and on into the fall, as we continue to look at new approaches to drive more of our core business, and also to give more to that consumer who's being caught up in the credit crunch. Now that we've managed through the majority of our excess inventory from the Rent Way acquisition and our store closing plan, we believe these traffic-driving programs can also be somewhat less promotional than they were over the last year, which will drive our margins up as we move through the rest of '08 and into '09.

On the collections side we continue to perform pretty well,as our quarterly weekly pass-through average was about 6.3%, 60 basis points lower than last year, and our best second-quarter average in six years. We're seeing the benefits of that in our skips and stolen losses as a percent of revenue, we ran 2.3% in the quarter, down from 2.6% in the first quarter, and down from 2.7% in the same quarter last year. Our inventory held for rent was within our normal range, coming in at 23.2%, similar to where we were last year at the end of the second quarter. I'll remind you our goal here is to be in the 20% to 24% range and that number's somewhat seasonal and is also highly affected by the timing of our bulk inventory purchases. In other words, if a large amount of inventory shows up at the end of a quarter for an upcoming promotion,that can drive this number up, as well. But again, this number at the end of the second quarter at 23.2% is right about where we would expect it for this time of year. As far as the store consolidation plan we announced at the end of last year, that's been substantially completed and we have reached our goal of $2 million to $2.5 million per month of pretax operating income starting with this past quarter.

In summary it was a very good quarter, despite the tough economic conditions. Our marketing and advertising plans around the tax stimulus checks worked well and we believe we're very well positioned to have more customers caught up in the credit crunch. We're working hard on operational execution and most notably on improving our gross rental margins, which I believe will start improving beginning in the third quarter. We also remain very focused on providing a positive customer experience, controlling those delinquencies that I mentioned, and managing our inventory and resources wisely. I'd like to thank our 18,000-plus co-workers on a job very well done and we look forward to continuing our journey and providing value to our co-workers, our customers and our shareholders.

Robert?

Robert Davis - *Rent-A-Center, Inc. - CFO*

Thanks, Mitch. I'm going to spend just a few minutes updating you on the financial highlights that we achieved during the quarter and then I'll turn the call over to Mark. And I would like to mention that much of the information I provide, whether it's historical results or forecasted results, will be presented on a recurring and comparable basis. As outlined in the press release total revenues were $719 million during the second quarter of 2008, a decrease of less than 1%, or $5.2 million, despite having 10% fewer stores in the period as a result of the consolidation plan announced last fall. However, we did post a positive same-store sales comp of 0.9% versus an expectation of being flat during the quarter. Net earnings and diluted earnings per share were $37.7 million, and $0.56 respectively, and were within our guidance range for the quarter.

We are very pleased with these results during the challenging economic environment. In fact, our results during the quarter were negatively impacted by approximately $2.5 million, or close to $0.03, as a result of the ramp-up of a new product offering by our subsidiary, dPi; namely a prepaid energy product for consumers, primarily in the state of Texas. During the second quarter energy prices in Texas were extremely volatile, and several competitors in this space were forced to exit the business. And again, this volatility had a negative impact to us of about $0.03. dPi has since secured favorable rates through short-term contracts for the balance of the year and we estimate a break even for the next couple of quarters as this business continues to ramp and we become more familiar with customer acceptance and behavior, as well as sensitivity to pricing in efforts to improve margins.

Now, there could be some upside to that in terms of the results of those secured rates going forward, but we are not forecasting that at this point in time, but there could be some slight upside in that. And just so everyone is aware, the way that revenue comes in, it is reported on our income statement, the sales associated with prepaid products for dPi show up in the merchandise sales line and the costs associated with those prepaid products are in the cost of sales line and given the impact of the $0.025 in earnings dilution in this quarter that did have an impact on our margins in the second quarter. Overall, a very positive quarter for us. Again, some slight upside potential as we learn more about customer behavior in those prepaid energy products, but we are not forecasting that at this time.

Our second-quarter EBITDA came in around $96.3 million, and a margin of 13.4%. All be it down from the second quarter of last year, it was 180 basis points higher than the last six months of 2007, reflective of the positive results posted this year in line with our expectations. Our operating cash flow has remained very strong, and was over $85 million during the second quarter and over $213 million during the first six months of 2008. This strong recurring cash flow provides the Company with many diverse opportunities in terms of managing our capital. As such, the Company has expended over $29 million in CapEx during the first six months of the year, as well as deployed close to $6 million in acquisitions of stores and accounts; over $3 million in share repurchases, which occurred during the second quarter, for approximately 150,000 shares; a net reduction in our senior debt of approximately $171 million, thus far for the year; as well as a reduction in our subordinated debt of close to $30 million, occurring during the second quarter, for a total of over $200 million in reduced indebtedness thus far during 2008.

As a result, our leverage at quarter end was reduced to 2.81 times, down from 3.08 times, or over a quarter turn decrease since year end and well below our current covenant requirement of 3.5 times, as far as below the 3.25 times covenant requirement that we'll be faced with at 12-31 of '08 this year going through the entire expiration of the facility, which will occur in June of 2012. So an awful lot of room and comfort for the life of the senior credit facility that exists today. At quarter end net debt to book cap equated to 49.7%, down 510 basis points from a year ago, and the lowest level in roughly two years since prior to the Rent Way acquisition. Having said that, at quarter end our debt levels were approximately $788 million in senior term debt, and $270 million in our 7.5% subordinated notes, while our second-quarter ending cash balance was just over $75 million.

Additionally since quarter end we have further reduced indebtedness by another approximately $24 million by making additional optional prepayments to our senior term loans. Our cash flow and leverage levels are strong and healthy, and so we continue to strengthen our balance sheet. We feel very comfortable where we are with our leverage, liquidity, cash flow, and generally our overall capital structure in this period of economic uncertainty and turmoil. As always we will continue to prudently utilize our cash to invest in the business, delever the balance sheet, as well as make opportunistic share repurchases.

As it relates to guidance we anticipate for the third quarter of 2008 total revenues to range between $700 million and $715 million on same-store sales that are expected to range between a positive 3% and 4%, with diluted earnings per share ranging between $0.45 and $0.50. Now I will remind everyone this is the first time and first opportunity that we've had to give guidance for the third quarter of 2008 specifically. This range equals an expected increase of between 35% and 50% over the third quarter of 2007. For all of 2008, we are increasing our total revenue guidance to now range between $2.89 billion and $2.92 billion, primarily due to the increase in dPi revenues, all be it at lower margins currently. We are increasing our same-store sales guidance and now expect them to fall within a range of positive 1% and positive 3%.

Additionally we are projecting 2008 EBITDA of approximately $390 million and free cash flow to equate to roughly $260 million. Diluted earnings per share are estimated to be in the range of $2.20 and $2.30, the high side of that range of $2.30 being brought down primarily due to the impact of dPi this quarter. As always, this current guidance excludes any potential benefits associated with potential stock repurchases or acquisitions completed after the date of this press release.

With that update, I'd now like to turn the call over to Mark.

Mark Speese - *Rent-A-Center, Inc. - Chairman & CEO*

Well, thank you, Robert and Mitch, and good morning, everyone. Thank you for joining us this morning. Let me go ahead and add a couple of additional comments and then we'll open the call up for questions. First I want to add also how pleased I am with our overall performance during the second quarter, particularly in light of this continued difficult economic environment. As you read and Mitch mentioned, our overall results continue to run in line with our expectations and to some extent ahead of. Our delivery output continues to hold up, and while we saw a slight increase in payouts, as Mitch mentioned during the quarter, that was offset by lower returns. Net-net the portfolio is holding up as expected, and at the same time, our delinquencies continue to improve year over year.

You'll recall last summer proved very challenging for us, particularly June and July, where we saw a decrease in demand, increases in delinquencies and losses and lower earnings. Thus far, this summer is proving much different. In fact, as Robert mentioned, our guidance for the third quarter is up 35% to 50% over Q3 of last year. Certainly some of that is from the benefit of the store consolidation plan, and as Mitch mentioned, we are realizing the expected synergies from that. Yet at the same time we are seeing steady traffic and improved execution at the store level.

With regard to customer traffic let me share some insight we're now getting concerning the demographic profile of our customers. Our internal studies indicate that our active customer demographics have shifted upward in regard to income. This income shift up we believe reflects the tougher credit restrictions, increased energy and food prices and other economic factors making high-income families candidates for rent to own. And so while the lower income consumer may be being pushed out of the transaction, we are now seeing a higher-income customer being attracted to the proposition.

Of course Mitch also mentioned the renewed focus on the gross margin improvement now that our inventory is more aligned with our desires. And as he said, while it may take some time to realize we believe we can be less promotional going forward than we have been over the last nine months, and as such would expect our margins to improve over the next nine to 12. Again, Robert mentioned the impact that dPi had on those margins, as well, but setting that aside we believe that we can continue to improve the store operating margins on top of that. So all in all, quite positive. Of course, Robert also shared with you other highlights concerning the cash flow, debt levels, and our balance sheet, all very healthy and we believe we are well positioned for the future.

Let me spend a few minutes discussing our financial services business. I mentioned on our last call that we were nearing the completion of the workstreams that we had identified that needed to be resolved such that we would have a scalable platform and could begin opening additional stores. I am pleased to say that we have substantially completed the work. The systems are operating as designed, and we have, in fact, begun opening additional stores, having opened approximately 20 within just the last 30 days. We expect to be able to add approximately 20 stores a month for the balance of the year, adding the roughly 150 locations for the year that we spoke of. I'm also pleased to report that the stores continue to improve and are performing in line with our expectations.

With regard to payday lending in Ohio, as many or all of you know, in May the Ohio legislature passed House Bill 545, which significantly reduces the fees lenders may charge on short-term cash advances. The governor signed that bill June 2nd, causing an effective date of September 1st, absent a successful challenge. We do not believe the loan product permitted under House Bill 545 is a viable option, and we will not offer loan products under the new law. Now having said that, we and others in the industry in Ohio have joined together in support of a referendum that will allow the citizens of Ohio the opportunity to vote on a portion of the bill during the November general election. In order to qualify for the ballot in November, the group is required to submit 241,000-plus valid registered voter signatures from Ohio to the Secretary of State on or before August 31st.

Now this industry consortium has engaged signature-gathering firms to collect those signatures in hopes of meeting that deadline. If we are successful in gathering the necessary signatures, the effective date of the new law will be postponed from September 1st until shortly after the election, at which time the voters of Ohio will be asked to vote no on section 3 of this new House Bill 545, which is the section that repeals the current Ohio check cashing lender law. Now there can be no assurance that we'll be successful in either gathering the necessary signatures or if so, that we'll win the vote at the general election . If we are unsuccessful in either step, we would be forced to cease operations -- payday operations as currently designed in Ohio.

Having said that, we are currently evaluating other alternatives, including operating under other consumer loan statutes that are available in Ohio. I'll remind you, currently we have 54 locations in Ohio offering financial service products, of which most revenue comes from the short-term cash advance, which House Bill 545 eliminates. Given the early stage of development of our short-term lending operation in Ohio, should we cease operations it will not have a negative impact on earnings, as those stores in the aggregate are not yet contributing to earnings. We continue to evaluate the situation as well as look for alternative products and services that our customers desperately need and want.

All in all, it was a good quarter, and a good first half to the year. I remain cautiously optimistic about the near term, as I believe we're well positioned despite this continued difficult economic environment that we're in. Our focus remains on execution, driving traffic to the stores, providing the positive customer experience, maintaining our focus on collections and inventories, improving our margin, as we spoke, and managing our resources wisely.

We appreciate your support, and we'd now like to open the call up for

QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS) Your first question comes from the line of Dennis Telzrow with Stephens, Inc.

Dennis Telzrow - *Stephens, Inc. - Analyst*

Hello?

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

Good morning, Dennis.

Dennis Telzrow - *Stephens, Inc. - Analyst*

Good morning, good quarter.

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

Thank you.

Mark Speese - *Rent-A-Center, Inc. - Chairman & CEO*

Thanks.

Dennis Telzrow - *Stephens, Inc. - Analyst*

Obviously I have a question on this new product here for Texas. I guess my first question is, was that in your -- was that cost of $0.03 in your guidance for the second quarter?

Robert Davis - *Rent-A-Center, Inc. - CFO*

No, it was not.

Dennis Telzrow - *Stephens, Inc. - Analyst*

Okay. So that was not in your guidance. All right. That's a good answer, obviously. (LAUGHTER) Secondly, could you explain it a little bit more? I assume I might need it here since I'm in Texas, but a customer comes in and will be able to buy a certain amount of kilowatt hours, is that how it works?

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

Yes, Dennis, let me start, and Robert or Mark can chime in here. It's a prepaid energy product. We got that company, DPI, in 2006 when we bought Rent Way and they're in the prepaid -- up until now they've been in the prepaid telecommunications business, mainly home phone lines; expanded into the prepaid energy business because there's such a demand for it with our customer, and because the high deposits and so forth required maybe at the more -- the TXUs and those types of companies, do there's a demand for the credit-constrained customer for the prepaid electricity. And we're selling it not only in our stores but on the internet, they're selling it, and some other outlets, as well. So it's in high demand with that customer that we deal with and that others in our demographic group deal with.

So anyhow, they -- that's what drove the revenue up, they did a lot of revenue this summer as we've gotten into the product. And it drove the total revenue up, although in the ramp-up stages here and learning the business and understanding how to make money in it, obviously that subsidiary, as Robert mentioned, lost about $0.03. So that's what caused the high total revenue, if you look at our guidance from the second quarter, and the store revenue -- the store rental and fee we're right there. A little closer to the high side than the low side, as I recall. The comp was good. The total revenues got blown up high by this DPI price. It actually lost money, which affects that cost of goods sold margin. Instead of being in a range of 74% to 78%, it was I think about 81% or -- was a 81.1%.

Robert Davis - *Rent-A-Center, Inc. - CFO*

Right.

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

So, as the business is ramping up we had -- we really had almost no impact in our guidance, either from a revenue standpoint or an EPS standpoint. It drove a lot of revenue, which is the good news. Obviously losing $0.03 is the bad news. And that's -- I'm sure there's a lot of confusion out there about what happened with all the extra revenue and why it didn't get to the bottom line. That's the explanation. As Robert mentioned in his prepared comments we feel good about what we've done to lock in rates for the rest of the year in that business. That's why we raised our revenue in the annual guidance going forward because there's going to be more revenue there. Not adding to the EPS yet. We don't expect to lose $0.03 either. It's flat in there and as Robert mentioned, hopefully there's some upside in that as now -- now that the ramp-up is not completed but as we've learned the business, as the operator of that subsidiary has learned the business and now has the price right, the volati -- understanding the volatility in the Texas market, I think we'll worst case break even in the quarter and maybe there is some upside.

So that's the explanation on why there's a lot of revenue and -- but without the EPS it obviously affects those cost of goods sold margin in that subsidiary and there's -- it's a product that's in demand by our customer, the prepaid energy product. And if we can figure it out and make money at it, it could be a great thing. Obviously the first quarter doing it wasn't a lot of fun, losing $0.03 at it, but there is some upside in the business. And if there's not, if we can't figure it out, it's a business we can always get out of, too, so it's --

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Mark Speese - *Rent-A-Center, Inc. - Chairman & CEO*

I think it's important -- and I want to add -- to understand -- and Dennis, you being in Texas may know this. We went into it carefully and understanding the business in June, several of these smaller, independent, prepaid providers went bankrupt. As the energy really escalated they didn't have the backstop to fulfill it and they got pushed out of the business. That actually sent a lot more business to us than what we were expecting and so we got a lot more revenue than we anticipated. We got caught a little bit in the wave in that it was a prepaid customer who was locked in at a rate, but the energy cost had gone up and we weren't able to lock theirs down yet but we were willing to take it on to get the customer. So we brought in more revenue than we expected because several of them went out during the quarter, and didn't have the financial backing, if you will. We were able to capture the customer, it brought in more revenue than we expected, but we knew there was some flip on the expense, but as they said, we've got it locked in for the balance of the year and feel we can manage it.

It's a little speculative, but I don't want anyone to think that we were totally blinded given what happened in the market. And so we think -- we feel pretty comfortable. Again, we're still taking baby steps. Is this something we want to play with? We know there's a big demand, but it's -- how do you buy and sell, can you manage it and that's what we're working on.

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

The big demand is our customer. We're not getting into something that has a big demand that we're not used to dealing with the customer. In any ramp up, Dennis, you got to get the customer first, right, in any business model. What we proved to ourselves is that there's a demand. We certainly have that. And now with the rate changes we may be able to put in going forward, hopefully it does a little better than breaking even and we'll see as we go.

Dennis Telzrow - *Stephens, Inc. - Analyst*

All right, that's all I had. Thank you very much.

Mark Speese - *Rent-A-Center, Inc. - Chairman & CEO*

Thank you.

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

Thanks, Dennis.

Operator

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

Arvind Bhatia - *Sterne, Agee - Analyst*

Thank you. Good morning, guys.

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

Good morning, Arvind.

Arvind Bhatia - *Sterne, Agee - Analyst*

Good quarter.

Mark Speese - *Rent-A-Center, Inc. - Chairman & CEO*

Thank you.

Arvind Bhatia - *Sterne, Agee - Analyst*

Just again on that same topic a little bit more in terms of what you think is a market size and the applicability to that product perhaps to other parts of the country. And I think you were saying it's going to be breakeven in the next couple of quarters. Should we be expecting any contribution in the next year or is that still going to be early -- just give us some more color going forward on that, please?

Robert Davis - *Rent-A-Center, Inc. - CFO*

Well, let me start out, Arvind, by telling you that this product is only offered in Texas right now given deregulation in the Texas market, and so this is not a product that's available in all 50 states given the different regulations in various states. Again, as Mark mentioned, we're taking baby steps. We're not at this point familiar with customer behavior, rates, prices, churn, et cetera, and so we are not at this point in time ready to hitch our wagon to any long-term play in this product. But we do think there's demand for it. We've got approximately 20,000 customers right now. Again, some of those came through the impact of others going out of the business. They were flipped over to us and we took on that customer to capture that demand. But through the balance of this year is how we're looking at learning the business and see where we go from there as we get more experience in it.

Arvind Bhatia - *Sterne, Agee - Analyst*

Got it. And then a question on the store consolidation. Mitch, you mentioned you were right on track with that. Just wondering when you look at the cost of the stores that were closed, I think there is still some ongoing costs that you've kept; for example, maybe some people, maybe some of the trucks are still there, and I don't know if you're still paying for some of the leases, et cetera, help us understand where you are in that process and will we see some more benefit in the next quarter? In other words, the $2 million to $2.5 million, is that going to be even across the next couple of quarters, or is that -- is it high now and then it's going to be lower in the future quarters?

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

I think it's pretty even. I think we've gotten substantially all of the benefit from that. I don't think it goes down. It can go up. As those stores that got the accounts grow certainly you leverage the business and add profitability, but as far as directly relating it to the closing plan that we announced last fall I'd say we're there. It's in our numbers. As we mentioned, in the third quarter, when you go year over year we're somewhere between 35% and 50%, high side, low side of our guidance, earnings year over year, and that's partially due to the fact that this is turning into a better summer than last year, at least what we've seen so far, as well as the consolidation plans, so those two things are contributing to that really high growth of as much as 50% in the third quarter. So it's already there. We are still paying some of the leases, but that's being expensed out of the accrual that we made last year when we took the one-time charge, so we're not out of all the leases but there's -- and that's in the Q each quarter as far as how much is left that we're paying and so forth. So there's some cash requirements on those leases, although there's not a lot, but nothing that -- nothing really that would impact earnings. And the little bit of cash requirements still left on those leases will be out in the Q when its out later in the week.

Arvind Bhatia - *Sterne, Agee - Analyst*

Okay. And my last question is on the product side. Is there any trend there that you can mention perhaps on either the TV category or any of the other categories, any pluses or minuses, and as you talk about this higher income demographic is there any change in the trend and what they are renting, perhaps that group is renting? Anything to talk about there?

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

Well, the -- flat panel technology still continues to be one of our strengths. And in fact, we're -- as we see deflation in that product we now go all the way down to 22-inch sizes in flat panel in the stores now that the prices are coming in line. And what we're really focused on, Arvind, is making sure we have products for both and anyone in the middle, for both the higher end customer and the lower income customer. Mark talked about how we're seeing in the data we looked at, so far, an income shift up and presumably we're losing some on the bottom end and gaining some on the top end from the data we've seen.

But what we're trying -- the flat-panel technology is very popular, but that's why we want to have a 60-inch size and a 22-inch size. We want to have a laptop with all the bells and whistles in it that would be powerful enough for any of us to run our companies on and then down to a PC with a -- we can't get CRT monitors anymore, but with a 15-inch monitor that might be $80 a month versus $150 a month from range. So the flat-panel technology is popular, the laptops are popular, and we're focused on having both for the higher income customer that Mark talked about coming in, but also to try to stop any of the loss on the bo -- on the other end make sure we have those products -- again, it's flat-panel technology, but in the 22 or 26-inch size. So the flat-panel technology is something that's very positive certainly for the electronics industry and it's helping us along the way, as well.

Mark Speese - *Rent-A-Center, Inc. - Chairman & CEO*

Well, I could add, though, that from a -- the furniture's been soft for a long time, Arvind, and it's still a little soft relative to the others. But it's actually slowed down a little. It's stabilized, I guess, not slowed down. It's starting to stabilize, but it's been a soft category for quite a while.

Arvind Bhatia - *Sterne, Agee - Analyst*

Got it. Thanks, guys.

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

Thanks, Arvind.

Operator

Your next question comes from the line of John Baugh with Stifel Nicolaus.

John Baugh - *Stifel Nicolaus - Analyst*

Good morning. I don't understand this DPI transaction. Help me understand what exposure going forward. I'm not as interested in what you inherited, but are you basically guessing at where energy costs are going to be and then putting a profit margin on that with the customer? What's the duration of the prepay or how much forward do you have to get -- help me understand the true nature of the transaction and the exposure, and you mentioned you've locked in -- I need help.

Robert Davis - *Rent-A-Center, Inc. - CFO*

Yes. John, this is Robert. Essentially, as it relates to the fluctuation in energy prices, to some extent, as Mitch indicated, it is speculative in terms of how energy prices will change seasonally throughout the year. But effectively, our exposure is, we've locked in rates from here through the balance of the year on a good portion of the demand that we anticipate, not all but a good portion of it, at a rate that is far below what we were paying the last couple of months, last quarter. Off of that, yes, we do charge the customer a rate to allow the certain profit margin that you're anticipating and we've since increased those rates and lowered our cost going forward relative to what we were at in the second quarter. That's why we believe there may be some upside in the back half of the year, but we do not forecast that in the guidance that we've given you until we learn about customer churn. Are the rates that we're charging the customer such that there's higher turnover in that customer base than we'd like? We just don't know that yet. But I'll remind everyone, this is a small portion of the entire business at large and so --

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John Baugh - *Stifel Nicolaus - Analyst*

So help me understand, Robert. You're contracting with the supplier of the energy at a set price for a set period of time, and then that customer -- your customer gets that rate plus your profit margin, so there's technically no exposure if you're way off, if energy prices in that interim contractual period go way up or way down you don't benefit or -- help me understand exposure there.

Robert Davis - *Rent-A-Center, Inc. - CFO*

You're right and the point I'm making about the rates that we've locked in it's for the majority of the demand that we anticipate through the back half of the year, but not all. So some exposure could be on rates, on the unlocked portion, but you're able to sell energy back into the open market if there's no customer demand there and so how those dynamics work is something that we'll continue to learn. But you have the basic genesis of the transaction. You're paying a rate for energy, you're charging the customer higher rates to get an anticipated margin and profit, and that's kind of how we're forecasting the balance of the year in terms of what we expect. That benefit that is the differentiation between our costs and the revenue that we anticipate is not in our guidance right now until we learn the customer behavior, the customer churn.

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

And the customer's prepaying, John, on a 30-day basis. You can raise prices every 30 days on that customer so you can react pretty quickly to the market. Obviously the second quarter was a little bit of learning experience for us and the people that run that subsidiary as far as what they needed to do with the rates and in the ramp up that's what tends to happen. But it's not -- we're locked in the -- we're locked in the rest of the year on a majority, as Robert said, but in any event you can increase prices or decrease prices within 30 days. You're not locked in that long with a customer because they're prepaying on a 30-day basis, so we can react pretty quick and shouldn't -- now learning from what we learned in the second quarter and the first real quarter we're in the business, a loss like that when you can just -- in this case just pass it on to that customer, a loss shouldn't happen like that again like that.

John Baugh - *Stifel Nicolaus - Analyst*

So you can adjust with an existing customer 30 days or are you talking about when you get a new customer in, if energy prices have jumped dramatically and you can get that new customer at obviously a higher rate. What -- which one?

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

Both. Either the new or the existing you can adjust after 30 days, which should -- again, that's why once you are in the business and learn from the experience we had in the second quarter should be able to not have that ever happen again because you can react pretty quickly.

John Baugh - *Stifel Nicolaus - Analyst*

Okay. And then my second question quickly is, in your guidance for Q3 on sales and salaries and other for stores, it implies a mid-point of 59.2% I believe. And I know there's some level of seasonality second quarter to third quarter, but sequentially that's a big increase from the quarter you just reported, where I believe it was 57.3%. Can you explain to me why that number is so high. With 10% fewer stores that number is certainly not down 10% in dollars. Just help me with the leverage or lack of leverage? And I understand it's down year over year for the third quarter a year ago but sequentially it's picking up.

Robert Davis - *Rent-A-Center, Inc. - CFO*

Yes, John, the guidance that we've given implies that the margin has gone up, but that's driven by two primary factors. One is the seasonality. Overall revenue for the second quarter is expected -- for the third quarter is expected to be lower than the second, so even if the dollars stayed flat the margin -- the costs will go up as a percentage. But coupled with that -- and so that's one primary factor, just the revenue impact going down seasonality-wise, but the other impact is driven by the anticipated ramp in financial services locations that we're starting up again. So as we go through the balance of the year, if we're going to open up 20 stores a month we're going to have some added costs associated with that and that's the other part of the guidance. You will see year over year from the third quarter of last year to the third quarter guidance that we're giving, if you run just the percentages, that the overall dollars will be down and it's consistent with that $2 million to $2.5 million range roughly of what we are benefiting from relative to the store consolidation plan. So two primary drivers are lower revenue but higher costs associated with ramping up the financial services business.

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

Yes, and I think I would add to that be, Robert. Keep in mind, John, with the revenue being lower in the third quarter there's also one more business day in the third quarter and the revenue's still down, but we've got to operate the stores one more business day and just the labor in one more business day is something like $2 million to $2.5 million, and then obviously every cost for one more day. So revenue -- seasonality is the short answer and if you look at the last year, we were up from 53% to 60.6%, 2.3% from second quarter to third quarter, and if you look at this year and use the mid point of our guidance up, what, about 1.8% or 1.9%. So it's less of an increase than last year , it's just the short answer's

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John Baugh - *Stifel Nicolaus - Analyst*

Okay. And my last question quickly is maybe for Mark. Yes, if you care to comment on it. If Ohio doesn't -- if you're not successful there, any thoughts what you'd do there? Would you camp out and see if all the others fail and you can make up the volume what you lose from margin or there's just no way to really operate in Ohio if that law goes into effect?

Mark Speese - *Rent-A-Center, Inc. - Chairman & CEO*

Well, as I mentioned, we're obviously in the interim doing several things, not the least of which is working on the referendum, but in addition exploring other consumer loan laws that may allow us to offer this or a similar product. To your point, we're a multiline in the financial services. Beyond the short-term loans that we do we do check cashing and money transfer and other prepaid products. Certainly most of the revenue comes from the short-term loan. Can we do enough with absent that, I guess, to have sustainability and I don't know. Obviously we're in a little bit different position relative to the others in that we've been able to leverage a lot of our costs -- infrastructure, the real estate and so forth -- so we don't have as much incremental cost.

But I -- we're cognizant and I'm a little hesitant to answer for sure right now today because we don't know, but might there be a possibility that we could continue to offer other products and perhaps even more than what we're doing today, either from a product end or simply more volume or business for the reasons you've stated? If there's not others there providing on these other products and services, does that in by itself give us enough to where we've got sustainability? And we're in a position to where we can test that out for a while. I know some have come out and effectively September 1st they're going to shut their doors. Absent this referendum September 1st we will not offer the loan product, but I don't think we're going to shut our doors September 1st. We'll continue to take some time and evaluate the other products, services, and demand and see what we can do with it.

John Baugh - *Stifel Nicolaus - Analyst*

Thanks for answering the questions.

Mark Speese - *Rent-A-Center, Inc. - Chairman & CEO*

Yes.

Robert Davis - *Rent-A-Center, Inc. - CFO*

Thanks, John.

Operator

Your next question comes from the line of Carla Casella with JPMorgan.

Carla Casella - *JPMorgan - Analyst*

Hi. My question's related to your purchasing. When you're purchasing merchandise for rent in the store, are you getting any type of -- do you get -- are you seeing any special deals in this type of a market where maybe the electronics supplier is trying to get rid of merchandise, or --

Mark Speese - *Rent-A-Center, Inc. - Chairman & CEO*

It's kind of going both ways, isn't it, Mitch?

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

The electronics manufacturers are -- have been pretty aggressive, I'd say. We always at our buying power feel like we're getting good deals and when we -- if we buy a product to bring the stores, we're buying -- with 3,000 stores we're buying 10,000 to 15,000 of them and we usually get a pretty good deal. But I'd say you see a little bit of softening in the electronics side helping the prices. I think that's happening on the electronics side. On the other side of the coin, probably 60 or 90 days ago we had a price increase on appliances because the cost of steel and so forth. So I think where we're seeing electronics getting better deals, the fuel costs and energy costs hurt us a little bit on the appliance side.

Mark Speese - *Rent-A-Center, Inc. - Chairman & CEO*

Right.

Carla Casella - *JPMorgan - Analyst*

Oh, okay. And then did you change your EBITDA target or did you comment? I missed that if you said anything.

Robert Davis - *Rent-A-Center, Inc. - CFO*

The EBITDA estimate is $390 million for the year and that's consistent with the guidance that we gave last quarter of $390 million to $410 million. We've just locked in on one number at this point.

Carla Casella - *JPMorgan - Analyst*

Okay, great. Thanks.

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

Thanks, Carla.

Operator

Your next question comes from the line of Joel Havard with Hilliard Lyons.

Joel Havard - *Hilliard Lyons - Analyst*

Thank you. Good morning.

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

Good morning.

Joel Havard - *Hilliard Lyons - Analyst*

On the debt side -- I guess more Robert -- could you talk about where the revolver was at the end of Q2 and given whatever happens with cash flows over the second half where your emphasis would be on further debt reduction?

Robert Davis - *Rent-A-Center, Inc. - CFO*

At the end of the second quarter the revolver had no outstanding balance. It was undrawn in terms of outstanding indebtedness.

Joel Havard - *Hilliard Lyons - Analyst*

Okay. And that's down from $100 million-plus in Q1, if I recall. Is that right?

Robert Davis - *Rent-A-Center, Inc. - CFO*

No, it was paid up in the first quarter also, but it was over $100 million at year end.

Joel Havard - *Hilliard Lyons - Analyst*

Oh, okay. Okay, then to push that to the next step then, the focus of debt reduction from here in the second half, given whatever happens to your free cash flow and also how that would fit with you all starting maybe to get back into the share repurchase stance?

Robert Davis - *Rent-A-Center, Inc. - CFO*

Yes, I think we've historically deployed our capital on many fronts, whether it's deleveraging or making opportunistic share repurchase. We did dabble a little bit in the market in the second quarter, although not significant relative to how we performed last year in share repurchases. Some of that's driven by timing, some of that's driven by share price, but also we wanted to have an increased focus on leverage given the environment, the market, and some of the rhetoric that was going on in terms of Company's balance sheets and we just wanted to put ourselves in position to be very strong as it relates to our balance sheet. Again, we're far below our covenant requirements and even the covenant requirements that are going to be stepping down at year end through the balance of the agreement that expires in 2012. Having said that, we'll evaluate going forward what the best option is relative to rates, share price, et cetera, et cetera.

We did have an opportunity in the second quarter to buy some subordinating notes in the open market and so that remains an option to us. If you think about our interest expense and the cost of debt. If we're going to pay down or delever our outstanding indebtedness based on debt that you can't get back if you will, in other words, not revolver, then I'd rather pay down or buy back subordinating notes than senior debt, given the interest rates that we're paying on those. So that remains an option, as well.

Joel Havard - *Hilliard Lyons - Analyst*

Is there still a premium on the notes?

Robert Davis - *Rent-A-Center, Inc. - CFO*

There is a premium on the notes.

Joel Havard - *Hilliard Lyons - Analyst*

Okay, but still at 7.5%, right?

Robert Davis - *Rent-A-Center, Inc. - CFO*

Right. To the extent you tender for them, then yes, there is, but we had an opportunity to buy them on the open market, at a slight discount to par.

Joel Havard - *Hilliard Lyons - Analyst*

Okay. Okay. Then you know I need a bulletpoint version of this, so emphasis still on debt reduction, but that's not to say that repurchases can't happen again?

Robert Davis - *Rent-A-Center, Inc. - CFO*

Fair enough, yes.

Joel Havard - *Hilliard Lyons - Analyst*

All right. Thanks, guys, good luck.

Mark Speese - *Rent-A-Center, Inc. - Chairman & CEO*

Thank you.

Operator

Your next question comes from the line of Laura Champine with Morgan Keegan.

Laura Champine - *Morgan Keegan - Analyst*

Good morning. Could you talk a little bit about the general trend in terms of charge-offs and delinquencies and whether or not you're seeing significant regional differences in those trends?

Mark Speese - *Rent-A-Center, Inc. - Chairman & CEO*

Mitch, you want to take that?

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

Not necessarily regional differences. The delinquency of 6.3% past due on the average Saturday night throughout the quarter, including the holiday weekend of Memorial Day, was our best second-quarter average in six years. And our 2.3% skips and stolen -- excuse me, we have some noise in the background. The 2.3% skip and stolen number for the second quarter was 40 basis points lower than last year and 30 basis points lower than the first quarter and the best in two years. The best in a couple years. So we feel very good about that, the collection side and certainly good about the traffic, as we mentioned earlier. So the business from that standpoint as far as traffic, obviously we raised our -- we beat our same-store sales and raised the guidance going forward on same-store sales, so feel real good about the business trends both on the sales side and the collections side.

Laura Champine - *Morgan Keegan - Analyst*

And this may be related to that question, but can you put more color around your comments that your income demographic improved? Can you give us an order of magnitude or how you see that impacting the business going forward?

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

Well, what we did, Laura, was look at -- our advertising folks did -- at our 2005 customer-base addresses and so forth and information we had on the customers from 2005, compared them in the second quarter of 2008, and as we look at income brackets, every $10,000 income bracket, from $10,000 to $20,000, $20,000 to $30,000, $30,000 to $40,000 and so forth, the bottom two -- or actually the bottom one, the percentage had gone down, the second one up was about flat, and then every category above that had gone up.

Mark Speese - *Rent-A-Center, Inc. - Chairman & CEO*

$30,000 and above every one had gone up.

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

So there was certainly a shift from the lowest category that we look at to -- all the way up through the highest category, which of like $75,000, so a $75,000 household income. So a shift that we believe is probably because of the credit crunch out there, the higher costs, you lose a little with the -- on the lower income consumer, but those same costs are affecting the people that maybe were a little outside our income levels on the high side before the credit crunch and before gas was $4 or $5 a gallon and so forth.

So it's definitely driving some higher income families into the transaction, moving some on the lower end. We're focused, as I mentioned earlier, to make sure that we have products for both, so that we have the 60-inch flat panel, and then we have the 22-inch flat panel so that we can try to stop any of that loss on -- of the lower income consumer. So about what you'd expect in this kind of environment. This is a business model that is -- that over the years has performed in any economic cycle and that's the reason, because it -- what you lose on one side you pick up on the other. That's why this has worked through a few recessions, just since me and Mark have been in business the last 25 or 30 years.

Laura Champine - *Morgan Keegan - Analyst*

Got it. Thank you.

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

Thanks, Laura.

Operator

Your next question comes from the line of Emily Shanks with Lehman Brothers.

Emily Shanks - *Lehman Brothers - Analyst*

Good morning. Just a follow up to that question -- thanks for the detail around the different categories -- at which one did you start to see the pickup? Did you say the $30,000 to $40,000 household income range?

Mark Speese - *Rent-A-Center, Inc. - Chairman & CEO*

Yes, I think the increases were $30,000 to $40,000 and $40,000 to $50,000.

Emily Shanks - *Lehman Brothers - Analyst*

Okay, great. Thank you.

Mark Speese - *Rent-A-Center, Inc. - Chairman & CEO*

Yes.

Emily Shanks - *Lehman Brothers - Analyst*

And then in terms of the additional debt pay down post quarter end of $24 million, can you tell us which tranche of the term loan that was done in, A or B?

Robert Davis - *Rent-A-Center, Inc. - CFO*

That was done in B.

Emily Shanks - *Lehman Brothers - Analyst*

B, okay. Great. And then as we look at just -- just a couple of housekeeping questions, CapEx guidance for 2008, is it still 70ish million?

Robert Davis - *Rent-A-Center, Inc. - CFO*

I'm Sorry?

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

CapEx, $70 million?

Robert Davis - *Rent-A-Center, Inc. - CFO*

Yes, that is correct.

Emily Shanks - *Lehman Brothers - Analyst*

Great. Just in terms of generic working capital away from the net investment in rental merchandise that you're expecting, what do you expect working capital to be, flat, use, source? Can you give us any color around that?

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

Well, we would expect an increase in working capital on the loan side as we put more cash out on loans for the balance of the year. That's roughly $12 million for the year, I believe, in net investment in that category. On the inventory side, we actually expect some benefit there of roughly the same amount. And so for the year, basically a flat net investment in working capital.

Emily Shanks - *Lehman Brothers - Analyst*

Great. Thank you.

Operator

Your next question comes from the line of Andrew Berg with Post Advisory Group.

Andrew Berg - *Post Advisory Group - Analyst*

Hey, guys, just going back to the capital structure first, can you tell me what you have available on the revolving credit facility? I'm assuming there's some LCs, so you don't have the full availability.

Robert Davis - *Rent-A-Center, Inc. - CFO*

Yes, out of the $400 million on the revolver there's roughly $140 million on LC's outstanding, and so liquidity of approximately $260 million.

Andrew Berg - *Post Advisory Group - Analyst*

Okay, great. And then going back to the question previously about Texas DPi and the energy. If we try and just maybe quantify it a little bit better, you guys are technically long power that you've bought, which you can hopefully sell to customers at a profit or resell in the market if there's not the demand for it. But if we just try and say -- can you tell us what the dollar amount is that you're net long on power that you've purchased in the aggregate that you own and now you either need to resell to somebody or resell back into the market?

Robert Davis - *Rent-A-Center, Inc. - CFO*

It's very small. It's roughly $2.5 million.

Andrew Berg - *Post Advisory Group - Analyst*

Okay. So it's a rounding error.

Mark Speese - *Rent-A-Center, Inc. - Chairman & CEO*

Yes.

Andrew Berg - *Post Advisory Group - Analyst*

Okay. And then in discussing your capital structure and your desire to buy back debt and you expressed a preference for the 7.5% sub notes, is there a limitation on what you can buy back under your bank credit agreement, or do they give you pretty free rein?

Robert Davis - *Rent-A-Center, Inc. - CFO*

There is limitations based on credit ratios; however if our senior leverage is below 2.5 times it's unlimited and currently it is below 2.5 times so we're unlimited.

Andrew Berg - *Post Advisory Group - Analyst*

Very good. Thank you very much, guys.

Robert Davis - *Rent-A-Center, Inc. - CFO*

All right, thanks.

Operator

Your last question comes from the line of John Curti with Principal Global Investors.

John Curti - *Principal Global Investors - Analyst*

Good morning, I have two questions. First off, can you give us an updated guidance on the anticipated drag from the financial services this year? That's my first question.

Mark Speese - *Rent-A-Center, Inc. - Chairman & CEO*

Still pretty consistent with what we had. $0.06 to $0.08 was what we had talked about earlier in the year and that outlook hasn't changed.

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

Yes, they're performing about what we expected them to be right now, so it'd still be in the $0.06 to $0.08 range, John.

John Curti - *Principal Global Investors - Analyst*

All right. Secondly, as you've picked up some slightly-higher income customers, are you seeing an increase in the number of items on rent or the average monthly or weekly rental fee? In aggregate or average ticket?

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

No. No, that's staying pretty consistent, even with that shift. Over the last year that's gone up. I can't tell you in the last quarter that there was much of a movement in it, but over the last year. And of course, the shift in customers that we're referring to is the difference between 2005 research and 2008 research. And I would -- between 2005 and 2008, yes, the ticket price is higher when you look over the three years to compare apples to apples. But over the last 90 days, it was pretty -- maybe a penny or two on the ticket price per month but pretty flat.

John Curti - *Principal Global Investors - Analyst*

Okay. Then lastly, how concerned are you about the proposal in Ohio spreading to other states? There's been a lot of noise in the press from some members of Congress about payday loans and the financial services aspect of the business, and how concerned are you about legislation spreading into more and more states, which maybe negatively impacts this business going forward?

Mark Speese - *Rent-A-Center, Inc. - Chairman & CEO*

Well, we're certainly very cognizant of it and I think it's fair to say have some concern. Having said that, I think it is important to note that there are 30 other plus states, 35 or so, that have embraced this business model and have enabling legislation and we don't believe are at risk. We do have in those cases as well as others, strong bipartisan support that, again, understands the proposition, the need for it and the value. It's not to say that it's not without risk and we're cognizant of that and working to educate where we can and where we need to. But I -- and you're right. We get -- there's some -- I don't know if noise is the right word, but there's some talk about it, the national level also and again, the -- that's on both sides. There were certainly many and some that understand it and are supportive of it and others that have questions about it, so we're continuing to work it on all fronts. But as we sit here today, there's nothing to indicate that there's an exodus that's about to happen, so we'll continue to work it as we have in the past.

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

And I might add to that Mark, and I think the whole industry see it this way. We certainly do. We welcome a lot of that as an opportunity to talk about the transaction with legislators like we did Rent-To Own 25 years ago. And once you can sit down and explain this to people they understand it's the best alternative -- most, at least, understand it's the best alternative for the customer rather than bouncing a check and paying those fees or having the energy -- having their electricity turned off and then paying a $300 reconnect charge or something that a fee on a payday loan is still a better transaction. So we welcome the opportunity to sit down and talk about it, like we have for the last 25 years on RTO, and show people, and most do get it once you can explain it to them that this is the best alternative in those tight spots for short-term loans. So we welcome the opportunity to talk about it.

John Curti - *Principal Global Investors - Analyst*

Okay. Thank you very much.

Mark Speese - *Rent-A-Center, Inc. - Chairman & CEO*

Thank you.

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

Thanks, John.

Operator

This concludes the Q&A portion of the call. Mr. Mark Speese, do you have any closing remarks?

Mark Speese - *Rent-A-Center, Inc. - Chairman & CEO*

Well, first, again I want to thank everyone for your time, interest, and support in the Company. Again, we're very pleased with our quarter, the results, the tone of the business. We believe we're well positioned. I recognize the little bit of confusion perhaps around DPI We hope we've cleared that up. We feel comfortable with where we are with respect to that and our ability to manage it, both in the near and long term as we continue to evaluate the business and what that may mean for us, as well. But as always, again, we appreciate your support. We're available for any follow up and we look forward to talking to you again next quarter. Thank you very much.

Mitch Fadel - *Rent-A-Center, Inc. - President & COO*

Thanks, everybody.

Operator

This concludes today's Rent-A-Center second-quarter 2008 earnings release conference call. You may now disconnect.