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RCII - Q2 2003 Rent-A-Center Earnings Conference Call

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OVERVIEW

Strong quarter of operating results for RCII, with a five for two stock split announced in a press release last night. Q&A Focus: rent inventory, increased expenses to salaries, and share buyback.

CORPORATE PARTICIPANTS

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

Mark Speese
Rent-A-Center - Chairman & CEO

Mitchell Fadel
Rent-A-Center - President & COO

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CONFERENCE CALL PARTICIPANTS

John Baugh
Wachovia Security - Analyst

Arvind Bhatia
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John Everett
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Alan Rifkin
Lehman Brothers - Analyst

Brian
- Analyst

PRESENTATION

Operator

Good morning and thank you for holding. Welcome to Rent-A-Center's second 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 one on your push button phone. As a reminder, this conference is being recorded Tuesday, July 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 would 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 operational and financial achievements we made in the second quarter of 2003. If for some reason you did not receive a copy of the release, you can download it from our website at investor.Rent-A-Center.com.

In addition, certain financial and statistical information that will be discussed during the conference call will also be provided on the same website. Also in accordance with SEC rules concerning non-GAAP financial measures, the reconciliation of EBITDA is provided in our earnings press release under the consolidated statement of earnings highlights. Finally I must remind you that some of the statements made in this call, such as forecast growth and revenues, earnings, operating margins, cash flow, and profitability and other business or trend information are forward-looking statements.

These matters are of course subject of many factors that could cause actual results to differ materially from our 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 three months ended March 31, 2003, as filed with the SEC. Rent-A-Center undertakes no obligation to publicly update or revise any forward-looking statements. I would now like to turn the conference call over to Mark. Mark.

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

Thank you, David. Good morning. I'm very pleased to report to you another strong quarter of operating results along with our announcement of the five for two stock split that we mentioned in our press release last night. I'd like to spend just a few moments and provide with you a high level overview, then I will ask Mitch and Robert to provide you with more detailed operational and financial results. Needless to say, I think as everyone knows it's been a very busy quarter for us and I'm pleased with our overall results. We enjoyed revenue growth of nearly 12% year over year, comps of 2.7%, which Mitch will speak to.

Earnings per share of $1.44, as well as continued growth in our market share through the new store openings and acquisitions. The overall cone of our business is in line with our expectation and I believe that the outlook remains very favorable. Initiatives that we've put in place over the last year and a half continue to provide results and I believe that there's significant opportunities still ahead. Let me just take a quick moment and give you a brief update on the Rent-Way acquisition. As you recall in our last quarter press release or conference call, we had mentioned that all of those acquired stores have been either consolidated into an existing RAC or fully converted to the RAC or Rent-A-Center platform.

By that I mean the IT systems, the inventory offerings, all of our marketing and advertising, the name change campaign, staffing, et cetera. I am pleased to report to you that those stores are operating in line with our expectations, and I believe that the long-term results will be consistent with other past acquisitions. Again, we don't see anything inherently different in these stores that would give us any different result than what we've experienced in the past. It's really at this point just timing as we continue to put our business model to work. Our new store openings are also performing very well. In fact, Mitch is going to share with you some results concerning those in a moment that I think you're going to find very encouraging.

Of course, as you also know during the quarter, the company announced its recapitalization plans. That included a new bank facility, new senior subordinated notes, all of that taking advantage of the lower interest rate climate. The tender of our existing or previous notes as well as the share re-purchase program in the form of a dutch tender auction. I think as most of you are probably aware, most of that has been completed, and I say most because while it was our hope or intention to have it all completed during the second quarter, the fact is not all of the bond holders accepted the early tender premium, nor were we able to re-purchase all of the shares that we had desired. With regards to the bonds, approximately 85 million of the original 250 million 11% bonds remain outstanding.

I will remind you that the company does have a call provision on August 15th of this year, approximately two and a half weeks from now, and we will tender for those remaining bonds at that time. Again, those have been replaced, you recall, with the new 300 million dollar 7 1/2% facility. Regarding the share re-purchase, and as part of that re-capitalization, the company offered to re-purchase 3.2 million shares of our common stock in the form of a dutch tender auction. Of that approximately 2.6 million shares were tendered at a price of $73 per share. That of course, was increased and extended from the original offer of $66 per share.

As we have said, we will continue to look at and evaluate further share re-purchases in the future. It is our intention to fully subscribe that tender that we had put out there. Our cash flow remains very strong. Robert will give you more detail. But essentially it does provide us with an awful lot of flexibility to execute our business plan, that includes anything from our new store openings to acquisitions and account buys, as well as additional share re-purchase and/or further debt reduction.

Of course the announced five for two stock split I think speaks to our confidence in both the near and long-term. This will create additional liquidity and flow, should broaden the shareholder base and should further enhance shareholder value. I'm certainly appreciative of everybody's support and we look forward to continued strong results in the future. Let me go ahead and turn it over to Mitch to provide you a little bit more detailed information on the operating results.

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

Thanks, Mark. It was a very good quarter for us as our growth continues in many ways. As many of you have heard us say before we have six different levers of recurring growth. The three areas that make up our reported comp, are revenue per agreement, agreements per customers and customers. The three that don't show up in our comp are the new stores, the acquisition of stores and the account buys from a competitor. These six levers will continue to drive growth force year after year in this very under penetrated business.

Obviously we're very positive about these numerous growth areas as evidenced by the announced stock split and the continuing stock re-purchase plan. Let's start with our comp for the second quarter. It was 2.7%, close to the middle of our 2 - 4% guidance range. It was driven by our average revenue per agreement continuing to climb as our customers continue to select the higher end products that we offer. With a customer comp that was flat to slightly negative. In fact, the customer portion of the comp was up about one per store or about 0.3%. I mentioned new store openings being one of our six levers of growth. That also causes a little bit of cannibalization as we expand in our markets.

In fact we have the ability through our IT system to track every customer from store to store. When we looked at customers in our newer stores, stores that are not in the comp base that transferred from a comp store that made up about an 8/10 difference. In other words, when we factor in our own planned cannibalization from new stores, our customer comp goes from a minus .3 to a positive 0.5, and our overall comp based on the revenue from those transferred customers goes from 2.7 up to 3.8. Another lever of growth I mentioned is account buys. These are the most accretive types of acquisitions as we buy accounts and add that to an already existing store with minimal overhead.

This is a very efficient use of capital and it's a growth lever that adds and will continue to be a very accretive growth lever for us going forward. When we buy accounts and we put them in an existing store we remove that existing store from our comp calculation. A very conservative approach for reporting comps, I might add. In the second quarter those buys added an additional 3.3% to our revenue and 3.7% to our customer base, none of which we take credit for in the comps. So although the comps of 2.7% are good retail comps, they actually are much better than that when you figure in the cannibalization of new stores adds an additional 1.1% and the non reported account buys adds another 3.3%.

And again, although our comp store customers are down slightly, we know through our IT system that those customers are still with us, just in a store that's more convenient for them. And when we have factored them back in our comp, those comp stores are still growing their customer base at the rate of 1/2 a percent even through they are on average more than five years old and at an income level per month that already generates over 25% store operating margins. In fact, even though they are mature stores and already very profitable stores, they still, when you factor in the cannibalization, are growing at a half a percent to their customer comp base. I mentioned our new store plan being one of our six levers of growth. I'd like to take a minute and update everyone on just how great that program is going. Since we started our Denovo opening plan in late 2000, we've opened about 210 stores. As most of you know, a new store in our model costs about $450,000 to open, starts turning a profit in about nine months and has a IRR of about 50% when you use a 6 1/2 times EBITDA terminal value.

As we reported previously our new stores continue to track ahead of that plan. In fact, we had about 70 of them hit the two-year mark during the second quarter. Now, the plan for that second full year is to make about $80,000 of EBITDA and at 10% store operating profit. That first group of stores we opened that recently hit two years old averaged over $131,000 of EBITDA against the $80,000 model and 14 1/2% store operating profit against the 10% model for the second year. We have another 50 stores that hit their one-year anniversary during the second quarter and they also really outperformed our plan. You may recall that our first year ramp up plan includes EBITDA losses of about $85,000.

That group of 50 stores that hit a year old last quarter lost only $23,000 on average in EBITDA in their first year against that plan of minus 85,000. So the new store plan is going extremely well and the opportunities continue to exist for this to be a growth avenue for us for numerous years to come. The new store program, as I mentioned began in late 2000 was initially a drag on earnings by about 30 cents in 2001. And while stores in their first nine months or so will always drag earnings during their ramp up period, the overall plan is now accretive and will continue to drive year over year earnings growth for many years to come.

As these 210 stores mature, based on the initial results I was just talking about, we are even more confident that they will add the earnings growth that we have modeled into our long-term plan of consistent 10 to 15% ongoing recurring growth. Additionally from a growth standpoint, we see the fast growing Hispanic population in our country as an additional tremendous opportunity for us. As most of you probably know, the Hispanic population is growing much faster than the population as a whole. It's now close to 40 million in size. In the second quarter we began a new full-fledged marketing program, including television commercials and print advertising geared specifically for the Hispanic audience, an initiative far surpassing previous efforts in this market. We're pretty excited about the opportunity that lies ahead for us on that avenue.

On the acquisition front as Mark mentioned the large number of Rent-Way stores and account buys purchased in the first quarter have been fully integrated and are operating on plan. That acquisition front remains very active as two more of our levers of growth. We bought 10 more stores in the second quarter, as well as 12 more of those very accretive account buys. The pipeline for future opportunistic acquisition and those account buys remains very positive as well. Our expense control initiatives remain a constant strength for us as evidenced by our record earnings and beating the consensus estimates by a penny.

Our collection efforts remain consistent. Most of you know our standard is to be at 6 1/2% or less of our customers, one day or more past due when the week ends on Saturday night. Even though it gets a little tougher to hit that standard in the summer months, we're right on it. So in summary a very fine quarter as we execute our six levers of growth while consistently controlling our collections and our expenses. With that I'll turn it over to Robert for a few financial highlights then we'll open it up for questions.

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

Mitch, thank you very much. I'd now just like to take a brief moment to provide some more detailed financial information and again we'll take questions at the conclusion of my comments. Total revenues increased 58.6 million or 11.8% to 553.3 million during the second quarter of 2003 as compared to the same quarter of the prior year. This revenue growth was driven by revenue from our new stores, acquired stores and account buys as well as growth in the same store sales base of 2.7% that Mitch outlined earlier. Now, as it relates to the growth in our store base, the second quarter we opened 18 stores as well as the 10 acquisitions and 12 account buys that Mitch outlined earlier.

For the year, to the day of this press release, we have opened 44 new stores, acquired 131, and have had 194 account buys, which has helped to drive the revenue growth. Now, as a result of this revenue growth and on a recurring basis our net earnings grew 16.6% and diluted earnings per share increased 18% over the second quarter of the prior year. The company did record approximately 27.7 million in nonrecurring charges associated with our re-capitalization that Mark briefly highlighted for you earlier, which, again, is not fully completed. We still have around 84 1/2 million dollars in 11% notes. Again, Mark mentioned that we do intend to call those bonds in August. When we do that, we will have an additional one-time charge of approximately $7 million during the third quarter of this year, and that will complete the debt portion of our recap strategy.

EBITDA for the quarter equaled $111.4 million for a margin of 20.1% as compared to a margin of 20.3% for the prior year. However when you exclude the impact of the acquired Rent-Way stores, the EBITDA margin actually increased 50 basis points over the prior year and came in at 20.8%. As we have outlined before we would expect on a reported basis this margin to remain relatively flat for all of 2003 as a result of our new store campaign in which we anticipate opening a total of 80 new stores this year, which are, as Mitch highlighted, a drag on earnings and profitability in their first year but is an integral part of our overall strategy to grow earnings 10 to 15% for the long-term. From a cash flow perspective, the company generated 58.6 million in operating cash flow during the quarter.

We also had about 13.7 million of capital expenditures in the second quarter. And at the end of the June 30 period, our leverage came in at 1.76 times. However, pro forma for calling the remaining 84.5 million and 11% subordinated notes, that leverage will be approximately 1.56 times, so 0.2 times turn once we call the remaining subordinated notes. Meanwhile, interest coverage ratio equaled approximately 5.7 times for the period ended June 30th. We're very comfortable with our current balance sheet and capital structure, as Mark highlighted, gives us the flexibility and confidence to be able to hit our growth initiatives on a go forward basis.

In terms of guidance for the third quarter of this year, we anticipate total revenues to be in the range of 546 to 551 million, same store sales of 2 to 4% and diluted earnings per share between $1.42 and $1.44. For the full year ending 12/31 we expect total revenues to be in the range of 2.21 billion and 2.24 billion, and earnings per share between 5.80 and 5.90. This guidance is after our new store initiatives but before the impact of any further acquisitions or account buys that may occur after July 28th, 2003. With that update, we'd now like to open the conference call to any questions that you may have. Operator?

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 one on your telephone keypad. We'll pause for just a moment to compile the Q&A roster.

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

Operator, you can go ahead.

Operator

First question from John Baugh from Wachovia Securities.

John Baugh - *Wachovia Security - Analyst*

Good morning and congratulations on a good quarter.

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

Thanks, John.

John Baugh - *Wachovia Security - Analyst*

Could you comment -- I think somebody referenced the pipeline looked good for either account buys or store acquisitions. Obviously you made a big deal in the first quarter with Rent-Way. Maybe you took a little breather in the second quarter. Could you just put a little more color on that?

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

Yeah, John, I think that's the right observation. When we bought those stores in the first quarter, we did decide not to do anything for a couple of months after that. In the second quarter it started to pick up again, 10 purchases plus 12 account buys.

And the momentum is picking back up. The pipeline, my reference to the pipeline remaining positive, it's as full as it usually is. We're not seeing any -- it's not like they are drying up or anything like that was the reason for my comment.

John Baugh - *Wachovia Security - Analyst*

The pricing on acquisitions, has that changed a appreciably.

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

Well, no, it's still -- it's a pretty wide range, as you know. You can pay anywhere from 6 to 10 times, most of them are probably more in that 7 to 9 range. But we pay as low as 6 times monthly revenue and as much as 10. No, we haven't seen a change there.

John Baugh - *Wachovia Security - Analyst*

Second question, could you comment on held for rent inventory, the ratio to total inventory, where that's trended the last few quarters and where you guess that might go going forward.

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

John, what you're referring to is the fact that the held rent or idle merchandise as a percentage of the overall inventory balance was about 21.3%. In the first quarter that was 19 1/2%, so it did go up a little bit in the second quarter, which is something that we planned for, quite frankly. Part of it is related to the Rent-Way acquisition. When we made that acquisition a lot of the idle inventory in the existing locations got merged into an existing Rent-A-Center store, which caused the idle balance in those stores to be a little heavier than normal, but certainly something we planned for. The second reason why is we have introduced a new product line this year. We're now carrying air conditioners. And we pre-purchased a significant number of air conditioners to get the right pricing that we wanted. But the fact is in the second quarter, those really didn't start going out until late in the quarter, and really didn't start picking up until July, which is something that we anticipated. So the 21.3%, we're not alarmed by it. We've always stated that anything between 18 or 22% is something we're comfortable with. Certainly it's within our expectations.

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

And to add to that, Robert, the expectation after the first quarter, because with all the sales that are done in the first quarter with income tax returns, it's very low between the fourth quarter and first quarter. In fact, Robert mentioned it went from 19.5 to 21.3. I think if you look at last year the increase from the first to second quarter was even bigger than that 1.8%, it was more like a 3%. A 3.2% last year, John, from first quarter to second quarter. This year only a 1.8 increase. So it's expected. Even though we added the air conditioners this year and they didn't really start to rent in ernest until July, because it took a while for the summer heat to come pretty much throughout the country, the increase was still not as high.

John Baugh - *Wachovia Security - Analyst*

Following up on that, then I guess you would expect that number ratio to drop in the third quarter and it might even drop more if we get the impact of the tax credit from child tax credit and early payouts as a result of that. Would that be a reasonable expectation?

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

I would expect it to drop a little bit in the third quarter. The third quarter is still not -- the business is tough until you get to the fourth quarter. But not knowing the impact yet of how those child tax credits are going to impact us, it's certainly possible that that will have more of a first quarter type affect and drop it. Other than that affect, it normally stays pretty consistent between the second and third quarter and then drops in the fourth quarter.

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

Here is a way to look at it, John, this is Mark, and I know we've said this before. At the end of the day what we do is try to maintain that 160 or 65 pieces held for rent in every store. We're at 167, it's at 20.3. If we're at 158 it's at 18.2 or something. At the end of the day, I think as Robert alluded to, it's anything between that 18 and 21%, if you will, that gives us, from an operations perspective, we're maintaining an adequate number of pieces.

John Baugh - *Wachovia Security - Analyst*

You guys don't want to hazard a guess as to how the child tax credit might help you in the third quarter.

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

I think we think there's some benefit there. I guess it was two years ago or thereabouts there was $600 for families and we saw an uptick. Certainly the first quarter of every year with the normal income tax refunds, we see a little bit of an uptick. That comes in the form of additional cash sales, purchase options and incremental rentals. It's hard to predict with any certainty. But as we sit here, yeah, I think we feel there could be some upside from it, certainly.

John Baugh - *Wachovia Security - Analyst*

Thank you. Good luck.

Operator

Your next question comes from Arvind Bhatia from Southwest Securities.

Arvind Bhatia - *Southwest Securities - Analyst*

Morning, guys. Okay. Mitch, you talked about different components of same store sales. Can you elaborate on those? You mentioned traffic - the way you report that's minus 0.3. Last quarter you did a great job explaining transactions per customer, increasing that and the pricing mix. Could you go over that as well this quarter?

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

The 2.7 was with the negative 0.3, the other 3% came, the majority of it, from the revenue per agreement. The mix ticked up slightly a little bit more for the customer but not really materially, like a half a percent of 2.2. The majority is the customers continue to select the higher end products.

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

The HDTVs.

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

The computers with the flat LCD monitors, instead of the old tube monitors. HDTVs are taking over the big screen business. Majority of the 2.7 was the revenue per agreement with slight uptick in the average number of agreements per customer.

Arvind Bhatia - *Southwest Securities - Analyst*

Last quarter you gave a number, 1.56 agreements versus 1.54. Do you have anything handy that you can speak to?

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

Right now it's about 1.57 per customer.

Arvind Bhatia - *Southwest Securities - Analyst*

How does that compare to last year?

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

Last year it was 1.54 -- it's a small part of our same store sales 2.7%.

Arvind Bhatia - *Southwest Securities - Analyst*

Gotcha. What do you do differently this quarter to get the traffic trend positive? I know you explained it eloquently with some of the cannibalization that might be going on. Is there something different that you could do this quarter, especially as we go into the summer months that could help us see, at least a flat, maybe a positive traffic trend, knowing that the other levers of growth are still strong?

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

Well, yeah. Mitch has probably got a couple of comments also. Obviously we're not going to not open new stores. I say that because that is part of this planned cannibalization. We could not open stores and that would drive it up, but that's not what we're going to do. I do think the introduction of air conditioners potentially is going to draw in business that we maybe had not gotten otherwise. Mitch did elude to from a marketing perspective as an example this Hispanic advertising that we're introducing. Again, it's not to say that we haven't done that in the past. What we have done is really committed some dollars to a specific program for that audience specifically. And that's television and some print support. But again, specifically targeted towards the Hispanic community. We are looking at some other advertising and promotional types of things that we hope will drive it. The fact is these customers continue to come into our stores. Mitch said they are continuing to stay with Rent-A-Center. Part of it, as we know, and as we've always alluded to, these stores get larger and larger. The fact that this is a neighborhood store, we're serving a defined customer with a typically pretty small radius of the store, there is some limitations. That's why the guidance that we've given out in the past at 2 to 4% takes that into consideration. You got some other questions?

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

We have a specific promotions schedule for each month. Obviously we feel very good about those promotions that we do. They are normal promotions that we do. We have a different promotion every month of the year. We will continue to do. And like I said, we obviously feel good about the promotions we've got scheduled for the third quarter, and we'll just see how well they've worked, as well as the stuff Mark mentioned. You may remember I think we mentioned last quarter a new loyalty program we put together for our customers. That just rolled out in the second quarter. We anticipate that to help in the third quarter. By loyalty program I'm talking about the diamond, platinum, and gold card that we sent to half a million customer that have been with us for years. There's a lot of initiative, the Hispanic, the loyalty program, the air conditioners and then our normal monthly promotion.

Arvind Bhatia - *Southwest Securities - Analyst*

I think, Mitch, I heard you say that the air conditioners did not rent until the beginning of July. So are you implying that you're hoping for some revenue from those in this quarter and maybe the unseasonably cooler weather on average throughout the country , that had an impact on that particular line and maybe that had some impact on same store sales.

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

I think it was slight. Yeah, the air conditioners aren't going to become a big part of our business. The affect that the air conditioners have sitting idle in June, at least 80 or 85% of them were still idle at the end of June has a much bigger impact on the health rent number we were talking about before than what it's going to do to the comps by renting them. If it had gotten hot sooner would the 2.7 have been higher? Yeah, it would have been a little bit higher.

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

We made some assumptions as to how many would be out.

Arvind Bhatia - *Southwest Securities - Analyst*

Okay. Then just an observation on the franchise revenue, which is a little bit lighter than what we had thought and downward since last year, anything going on there that we should understand?

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

Well, it's really just the trailing results of that store count dropping last year. You remember, if I can refresh your memory, it dropped 20 to 30 stores last year from late 2001 through 2002. And it's kind of a trailing affect of that. The store count at ColorTyme is on its way back up this year. They are going to have a growth this year. Most of the stores are going to open in the fall, so we'll see those numbers come back later in the year, because it's kind of a trailing affect. I'd also just remind anybody else looking at those numbers that it's about a $3 million difference in sales at ColorTyme for the reasons I just spoke of. That's about a 4 1/2% margin business. When they are off -- I'll even round up to 5%, when they are off $3 million it's a $150,000 impact. Don't read too much into that. It's a trailing affect of the store count from last year.

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

As you know, but maybe for the benefit of others, when we say that store count is off, realize Rent-A-Center bought those stores. In nearly every case we have that first right of refusal. And that was the case of a franchisee wanting to sell and so now it's a part of the Rent-A-Center family.

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

There's a lot more profit buying the store, especially if they were account buys, a lot more profit than that 5% franchisee profit.

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

That doesn't mean we don't want ColorTyme to grow. We want them to continue to grow and they are this year. It's just the trailing affect of that.

Arvind Bhatia - *Southwest Securities - Analyst*

Another, I guess, comment or question as well, this quarter, the June quarter, you had planned to buy back 3.2 million shares.

You bought only 2.6. You obviously assumed some accretion from the other shares which you didn't get, but you kept the guidance of the year. That sounded like to me that you in a way kind of raised your guidance. Would that be a fair assumption, fair observation?

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

There's a couple of components going on there, Arvind, and your observation is correct. I think the bigger impact in the second quarter was not the share buyback as much as it was $85 million of bonds at 11% interest. That had an impact in the second quarter on our earnings. The share buyback didn't impact us in the second quarter because it was so late in the quarter that it wouldn't have made a difference otherwise. However, on a go-forward basis, yes, we kept our guidance the same, 5.80 to 5.90. Had we gotten the full benefit of the share buyback and the bond tender, that's impacting us about 7 cents in the back half of the year, in the third and fourth quarter. However, -- so in other words our earnings could be coming down by 7/10 in the back half of the year because we didn't get that benefit. On the flip side, however, our tax rate is changing in the back half of the year, which we've outlined in the press release, mainly related to some of the tax initiatives we put in place early this year. We had some consideration in our tax rate in regards to the Texas state franchise tax that the legislators just met about two months ago or two weeks ago, and that expectation for that additional tax exposure was not passed by the legislature. There's still a slight chance that it could become a factor later in the year, but we think it's deminimus. The point is although we didn't get the full credit of the share buyback and the bond tender, there is an offset in the tax rate and we've kept our guidance the same the full year, 5.80 to 5.90.

Arvind Bhatia - *Southwest Securities - Analyst*

Got it. That's it. Thanks.

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

Thanks.

Operator

Your next question comes from John Everett from Capital.

John Everett - *[INAUDIBLE] Capital - Analyst*

Congratulations from me as well.

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

Thank you.

John Everett - *[INAUDIBLE] Capital - Analyst*

Robert, what's the cash -- I should have been able to figure this out -- but the cash and debt balances as of today? Are they different from quarter end?

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

The debt balance is $785 million. That's the new $300 million bonds, the new $400 million credit facility, and the $85 million of the old bonds that are still outstanding.

John Everett - *[INAUDIBLE] Capital - Analyst*

Okay.

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

The cash balance at the end of the quarter was $248 million in cash on hand. We do intend to utilize the majority of that cash to re-purchase the bonds, about $85 million worth on the bonds. And then the remaining portion will be utilized for stock re-purchase and normal ongoing inventory purchases.

John Everett - *[INAUDIBLE] Capital - Analyst*

And the stock re-purchase you refer to is actually not announced or authorized yet, but that would be a natural use of it?

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

Actually it's been announced and authorized. Through the new re-financing, we had the ability to re-purchase up to $214 million of common stock, which we only re-purchased about $185 million.

John Everett - *[INAUDIBLE] Capital - Analyst*

Gotcha.

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

The dutch tender.

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

So there's $30 million of cash or permitted use of cash through our credit facility.

John Everett - *[INAUDIBLE] Capital - Analyst*

Outstanding.

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

For additional re-purchase of stock.

John Everett - *[INAUDIBLE] Capital - Analyst*

Already out there. Great. And.

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

Excuse me, John, the 30 million and plus that growth with the basket every quarter, there's really more than 30 million available for us.

John Everett - *[INAUDIBLE] Capital - Analyst*

I like the way that was structured. The forecast for September had kind of a sequential increase in store salaries and others as a percentage, but it's actually kind of consistent with last year's ratio. Is that also kind of a seasonal factor there?

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

Yeah. There is some consideration for -- in fact just rolled out two weeks ago a pay raise to the account managers.

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

Tenured account managers.

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

Tenured account managers. Typically this time of year.

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

Utility costs are higher.

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

And there are other operating costs that have seasonality, utility and what not. Your question about the salaries, yeah, part of that is ongoing pay increases that are given historically this time of year.

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

Our insurance renewal every year is in August, John. Though it was within our expectation, the increase, everybody's insurance goes up every year. Two years ago we had a lot of problems. This year not a big problem, just normal increases but that's factored in, too. Normal increases in insurance are still significant.

John Everett - *[INAUDIBLE] Capital - Analyst*

Obviously being done in August makes September higher than June, which was really my point, I guess.

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

Yes.

John Everett - *[INAUDIBLE] Capital - Analyst*

It jumped out in the model. That's it, guys. Thanks a lot.

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

Thanks.

Operator

Your next question comes from Alan Rifkin with Lehman Brothers.

Alan Rifkin - *Lehman Brothers - Analyst*

Congratulations, gentlemen, on a very solid quarter.

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

Thank you.

Alan Rifkin - *Lehman Brothers - Analyst*

125 basis point improvement in salaries and other expenses is a pretty admirable number given the comp of 2.7. Would you attribute that to the acceleration and account buys or are you actually still seeing even greater benefits from the geographic pay plan?

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

You're right on both front. There is a benefit from the account buys. As you know, we roll in 100% of the revenues, so to speak, and minimal overhead associated with an account buy. You might need to add another employee in the store and so forth, but not the same level of expenses in an actual acquisition. On the same hand in the second quarter of last year, at that point we did not have the full benefit of the regional pay plan in place. And so that took through the end of December of last year before we started realizing quote, unquote, the full benefit of our expectations at that time, which was about 10 to 12 million annually. That is fully realized in the second quarter of this year, which last year it was really in its infancy.

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

I think a couple of other things, Allen, I thought you made the comment you're looking at it linearly, from a linear basis from the first quarter versus last year, unless I misunderstood your question. If you're looking from the first quarter to the second quarter, a couple of things happened. The fuel costs are down in the second quarter versus the first quarter, which is in salary and other, as well as some taxes on the salaries, employment taxes and stuff are higher in the first quarter and they drop off pretty quickly in most states. That's a little lower in the second quarter. A few other small things that help bring that number down in the second quarter and a constant focus on expense control.

Alan Rifkin - *Lehman Brothers - Analyst*

I was actually looking at it year over year, Mitch. Robert, to what extent do you believe improvements on the salary and other expense line are sustainable beyond this year. I know you've given us guidance for the back half of the year. Would it be incorrect on my part to assume that you should continue to see pretty significant reductions on that line item?

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

I think that would be inaccurate? I think as we previously commented here, there is seasonality in terms of operating costs from electricity. We did give some pay raises in the third quarter, which is factored into the model. And we have now realized 100% of the regional pay. Any ongoing benefit from that will be deminimus and not something you should expect going forward.

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

It's not that we've had 100% turn over since February of 2002 that we put that program in It's just that raises, it's been a year and a half and normal increases that managers can get and other employees can get are now leveling that line off.

Alan Rifkin - *Lehman Brothers - Analyst*

Okay. As you look at the marketplace and you assess whether to actually make an acquisition or just do the account buy, any sort of like quantification as to the difference in ROIC between either one of those growth parameters?

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

I think the ROI is better on account buys. It's the most accretive thing we can do. Obviously we buy stores, too. If we don't have a store in that area, buying the store will just give us that -- in most cases, depending on the location, but in most cases it's going to be as good, if not better, than opening a store there. You've got at least a revenue base to begin with. So buying a store still helps that long-term growth, because most of the stores we buy, the industry average is in the 40 to $45,000 a month range for revenue. Ours is in the $75,000 a month range. Historically we've been able to bring those stores all up into our operating model, bring them to 75,000. So when we buy a 30 to 40 to $45,000 store, which is most of the competition, it gives us a great growth opportunity for the next couple of years on that same store as well. It really comes down to whether we have a store in that area. If there's a store in the area and we don't need another one we'll do an account buy. If we don't have a store in that area, we'll do it as a new store, presuming that we like the location. It doesn't have to be a great location because there's short-term leases. We can always move the location, stuff like that.

Alan Rifkin - *Lehman Brothers - Analyst*

One last thing, if I may. As a percent of revenues, promotional activity in the second half versus last year, what could we be looking for there? Will it be up versus the second half of last year or pretty flat.

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

Are you talking about advertising promotion.

Alan Rifkin - *Lehman Brothers - Analyst*

Yes, uh-huh.

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

Should be similar to last year. When we talk about the Hispanic advertising, it's not as though we are spending incremental dollars. It's more of an allocation shift in the total spend. So from an overall cost of advertising, it's not going up materially.

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

Will put in a little bit more dollars because we're adding more stores. But as a percentage of revenue you're not going see.

Alan Rifkin - *Lehman Brothers - Analyst*

Beside a percent of revenues it should be pretty flat? Thank you all very much.

Operator

Question from Brian [INAUDIBLE]

Brian - - *Analyst*

All my questions were answered. Congratulations on another great quarter.

Operator

At this time I would like to remind everyone if you would like to ask a question, please press star and then number one on your telephone keypad.

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

Okay. Operators, that's the end of the questions.

Operator

At this time, there are no further questions.

Mark Speese - Rent-A-Center – Chairman & CEO Folks, thank you very much. We, as always, appreciate your time and interest, and as always we are available if you have any follow-up questions. Look forward to speaking to you again next quarter. Thank you.

Operator

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