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RCII - Q4 2013 Rent-A-Center Earnings Conference Call

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OVERVIEW:

RCII reported 4Q13 total revenues of $769.6m, net earnings of $13.1m and diluted EPS of $0.25. Expects 2014 total revenue growth to be 4.5-7.5% and diluted EPS to be $2.30-2.50.

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PRESENTATION

Operator

Good morning and thank you for holding. Welcome to Rent-A-Center's fourth-quarter and year-end 2013 earnings release conference call.

At this time, all participants are in a listen-only mode. Following today's presentation, we will conduct a question-and-answer session. (Operator Instructions). As a reminder, this conference is being recorded Tuesday, January 28, 2014.

Your speakers today are Mr. Mark Speese, Chairman and Chief Executive Officer of Rent-A-Center; Mr. Robert Davis, Chief Financial Officer and Chief Executive Officer Designee; Mr. Mitch Fadel, President and Chief Operating Officer; Mr. Mike Wilding, Senior Vice President, Accounting, and Global Controller and Interim 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.

David Carpenter - *Rent-A-Center, Inc. - VP of IR*

Thank you, Stephanie. 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 fourth quarter. If for some reason you did not receive a copy of the release, you can download it from our website at investor. Rentacenter.com. In addition, certain financial and statistical information that will be discussed during the conference call will also be provided on the same website. Also, in accordance with SEC rules concerning non-GAAP financial measures, a 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 collected in the forward-looking statements. These factors are described in the earnings release issued yesterday as well as our annual report on Form 10-K for the year ended December 31, 2012, and our 2013 quarterly reports on Form 10-Q for the quarters ended March 31, June 30, and September 30. Rent-A-Center undertakes no obligation to publicly update or revise any forward-looking statements.

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

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

Thank you David. Good morning, everyone, and thank you for joining us.

While I am deeply disappointed in the conclusion of 2013, I am very optimistic that the future remains bright for our company. We are the largest rent-to-own operator in North America with nearly 4700 touch points, and we have a well-defined corporate strategy in place to serve us well into the future, new defined strategies that have been developed over the last six to eight months that will act to improve performance in the near term while laying the foundation for consistent and resilient growth in the years to come. You're going to hear some about that today. And we're going to provide full in-depth details during our investor day presentation, which will be held in New York City in just two weeks on Wednesday, February 12.

As you know and as was announced several months ago, my days as CEO will come to a close later this week. Through the years, I have had a passion for wanting to help people more than anything, and it doesn't take much time in our stores to realize that what we do affects people's lives in a very positive and meaningful way. I felt what I was doing was relevant, needed, and important. And I began this company, then known as Vista Rent-to-Own, with a desire to do it better than anyone else. Since then and through the years, we have made a difference in the lives of millions of people. To say that the success we have enjoyed has far exceeded my expectation would be an understatement.

While I am excited to continue my role as Chairman of the Board, after 35 years, it is time for me to focus on other important things to me. And as such, I will be passing the CEO baton to Robert Davis, our Chief Financial Officer.

I have worked very closely with Robert for the past 20 years and have absolute confidence in his ability to lead the company. He has been instrumental in our success to date and will be an excellent CEO going forward as the company continues to move into an exciting new phase of its development. While Robert, Mitch, and Mike will provide more details on the recent results and provide insights into the future, I hope that I will be able to see all of you at our 2014 investor day, again, on Wednesday, February 12, in New York.

I want to close by extending my deepest thanks and appreciation to all of our coworkers who comprise the Rent-A-Center family, our customers, vendors, directors, and of course you, our shareholders.

With that, it is now my pleasure to turn the call over to our CEO Elect, Robert Davis. Robert?

Robert Davis - *Rent-A-Center, Inc. - CFO and CEO Designee*

Thank you, Mark, and thank you for your leadership and guidance that has taken this company from one store in New Jersey to over $3 billion in revenues in three different countries. We are all extremely grateful we have had an opportunity to be a part of it, and we look forward to continuing your legacy and are committed to furthering the returns that we have provided our shareholders, an average of over 17% per year since going public in 1995.

Now, in terms of our fourth quarter, as Mark mentioned, the quarter and year ended well short of our expectations. Mitch and Mike Wilding will provide more detail on our operational and financial results in a few moments, but suffice it to say we must get better and improve our overall business.

As Mark alluded to, during the fourth quarter, we launched a multiyear effort to transform and modernize how we go to market and serve our customers. We will dive deeper into the details of this program during our upcoming investor day, as Mark mentioned.

We believe in our business model and the value we provide to millions of customers that are a part of our family. It is no secret that companies like Walmart, Sears, Kmart, Big Lots and several others are now trying to provide similar services to the unbanked and underbanked consumer. So it is imperative that we do not take our market-leading position for granted. As such and as a result of our recent results and trends in the Core U.S. segment and the opportunity for us to deliver profitable long-term growth, we are intensely focused on building new competencies and new capabilities while continuing to support our Acceptance Now and international expansion efforts.

We recognize that the competencies and capabilities that have enabled us to arrive through industry consolidation to where we are today as the industry leader must be augmented with new capabilities in order to sustain our market-leading position. As a result, we will be transforming our end-to-end supply chain, developing a customer focused value-based pricing strategy through a multichannel environment, optimizing our store footprint while enhancing our ongoing market planning capabilities, enhancing our Acceptance Now offering by launching a virtual capability, overhauling our store labor and operating model, and innovating our digital eCommerce capabilities, all with the primary intent of turning around the recent trends in our business and growing our core U.S. segment once again.

Of course, we continue to remain very excited about our expansion into new channels and new markets, in particular Acceptance Now in Mexico. We will continue to support and grow both of these channels in 2014, but deliberately at a slower pace in order to focus on some exciting new innovations and to ensure that every square foot we add is of the highest quality. We are excited to announce that we will soon be launching a virtual Acceptance Now platform, which will combine with our main model to broaden our appeal and expand our growth potential.

We also recently deployed new innovations on our model, as we opened our first stores in the highly dense market of Mexico City. We believe that these innovations provide a foundation for sustained growth for years to come. While net store growth will slow a bit while we focus on these initiatives, this pace will ensure we are putting our resources towards only the most promising locations.

To support the renewed focus of the core U.S. segment while supporting our Acceptance Now and international expansion efforts, we recently restructured our executive management team in order to best position the company as we begin to write the next chapter of the RAC success story. Some of the changes include promoting Jeff White to EVP of the core business after he led the explosive growth in the Acceptance Now business. Mark Denman, who joined us as the lead operator of TRS when we acquired that company in 2010, will now be leading our Acceptance Now division. Joel Mussat is our new omni-channel executive, moving into this important transformational role after leading our growth efforts in Mexico. Ricardo Cordon will now take the baton and lead our growth in Mexico after serving the last several years in our international governance role. Rita Bargerhuff has been retitled as our Chief Customer officer and will report directly to me. And we also have a new CIO in Herman Nell who joined us in the fourth quarter after serving in a similar role at leading retailers. These are just some of the major changes made in our recent restructuring.

These changes -- this transformation we are undertaking is focused on our customer and ensuring that everything we do renews their spirit as they compassionately provide for their families to bring dignity and pride into their homes with the quality products and services from Rent-A-Center. We recognize this is a multiyear effort and it will not happen overnight, but the leadership team is excited about the opportunity in front of us and the direction we are headed as the market leader. As a result, we feel really good about where we are heading and the impact it will have on our 2014 performance.

We are deeply excited about what the future holds and how we will serve our customers now and in the future. We do look forward to providing more details and insights on the February 12 in New York City. And we look forward to delivering results in 2014 that are ahead of what 2013 ultimately delivered.

I would like to extend my deepest thanks and gratitude to our hard-working coworkers who have made and will continue to make us the market leader.

I will now turn the call over to Mitch for an update on our operating results by segment. Mitch?

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

Thanks, Robert, and good morning, everyone.

Starting with our core segment, we did finish 2013 with more agreements on rent than we finished 2012. As we've previously discussed, the primary reason for the core segment being down 5.5% on same-store sales for the quarter is our average revenue per agreement, or the ticket. The other reason is our revenue from customers exercising the early purchase option was down 25%, about 25%, in the quarter.

While our December agreement growth was well under our expectation, again, we did finish the year with more agreements on rent than the prior year. Our goal in 2014 is to maintain that agreement portfolio both in prior year while driving that traffic with more unique high-value offerings that do not drop our revenue per agreement.

On the collection side, it has been a bit harder than previous years as our customer remains under quite a bit of economic pressure. Our customer losses in the core rent-to-own segment came in within historical ranges, albeit at the high side of those ranges at 2.9% for the quarter.

Our inventory held for rent in the quarter ended the year at 24.2% of our overall inventory dollars, 30 basis points lower than last year, additional evidence that our problem is not a byproduct of us being unable to rent our inventory. In 2013, it was more about ticket and those early purchase options declining that impacted the revenue.

Regarding Acceptance Now, overall we remain (technical difficulty) performance in this segment. Although our December agreement growth in this segment was also well under expectation, same-store sale revenue in the quarter grew by 26.4% with operating profit of almost $15 million. Now, that would've been about $18 million without an additional on-rent reserve adjustment made in the quarter.

We opened 91 more kiosks in the quarter and 411 for the year, to end the year with 1325. Our metrics such as customer keep rate and collections remain on target here as the Acceptance Now results continue to track to our new store economics model for the overall segment. It's really helping us grow the overall US rental market. When you combine the core and Acceptance Now, you've got a revenue increase in the US of about 1.5% for the quarter. So, we are growing our US market share.

In our international segment, which is primarily Mexico at this point, we remain excited about the opportunity. Same-store sale revenue in the quarter grew by almost 26%. We opened an additional 63 stores in Mexico in 2013, and we were still able to improve our profit numbers for the year. Most of you will recall we had a goal of achieving four-wall breakeven in December, but with the exception of an additional on-rep reserve adjustment in this segment as well, we were four-wall profitable in December. In fact, one of the divisions in the country, the one with the oldest stores, made a slight profit, even after overhead in December. So again, pleased with our performance in Mexico and we remain excited about our opportunity in that country.

Overall, challenges remain in our core segment, but thanks to ending the year with more agreements than last year in the quarter and our strong Acceptance Now performance, we are growing market share in the US and we remain excited about our Mexico expansion. So, all is not lost. We need to continue to drive traffic into the four stores but do so with more unique high-value offerings that do not drop our revenue per agreement.

I would also like to thank our 20,000-plus coworkers for their dedication and hard work to improve the quality of life of our customers in these challenging times.

I'd now like to turn the call over to Mike.

Mike Wilding *- Rent-A-Center, Inc. - SVP, Accounting, Controller, and Interim CFO*

Thanks Mitch. I'll walk through our financial results for the quarter and review our 2014 annual guidance, after which we will open the call for questions.

As outlined in the press release, our total revenues were $769.6 million during the fourth quarter of 2013, an increase of $11.2 million or 1.5% as compared to the fourth quarter of last year. Our net earnings in the quarter were $13.1 million, while diluted earnings per share equated to $0.25, a decrease of approximately $0.55 quarter-over-quarter. These results include dilution related to our international growth initiatives of approximately $0.09 per share.

Let me take a few minutes to give more detail in several areas where we missed against our expectations. I'll start with gross profit. As a result of lower revenue than expected, gross profit was off our expectations $0.17, or approximately 30% of the miss, the core U.S. segment contributing $0.13 and Acceptance Now contributing $0.04.

As it relates to the unexpected expenses, I'll mention the impact of the most significant item -- $0.08 due to an increase in claims paid under our self-funded health insurance program, the primary driver that made an increase in large claims, a $0.03 impact due to severance for former executives of the company. Robert talked about the very strategic management changes earlier, [but since] that impact due to the increase, non-rent merchandise reserves and losses, a $0.04 impact on our effective tax rate -- due to our effective tax rate. The effective tax rate was higher in the quarter, primarily due to nondeductible goodwill being disposed of when we sold stores to franchisees as part of our ColorTyme rebranding initiative.

As a result of these items, consolidated operating and EBITDA margins declined in the quarter. Our fourth-quarter EBITDA margin declined 470 basis points to 8.2%. While we had net uses of operating cash flow of approximately $39 million during the fourth quarter, year-to-date we generated approximately $134.3 million in operating cash flow.

We continue to invest in new stores, new channels, and new markets. In fact, our overall location count has increased approximately 9% from the prior year and by 56 locations since September 30.

Dividends continue to play a vital role in our total shareholder return, and we did make our 15th consecutive quarterly cash dividend payment last week. We believe we have taken a fair and balanced approach to our shareholder return.

We ended the quarter with over $42 million in cash on hand. As noted in the press release, certain balance sheet line items as well as the 2012 statement of earnings for the three- and 12-month periods ended December 31, 2012 have been revised to correct immaterial errors from prior years. The comparisons I gave earlier contemplate revised 2012 numbers.

In terms of guidance, for 2014, we currently expect total revenues to increase between 4.5% and 7.5%. We expect our same-store sales for 2014 to range between a positive 3% and 5.5%. Overall diluted earnings per share for 2014 are expected to be in the range of $2.30 and $2.50, which includes an approximate $0.25 drag on EPS related to our international growth initiative.

In terms of EBITDA and free cash flow, the company EBITDA will approximate $325 million to $345 million. Free cash flow will approximate a negative $65 million, largely due to the reversal of our deferred tax liability. The 2014 guidance does not include the potential impact of any repurchases of common stock of the company -- that the company may make, changes to future dividends, material changes to outstanding indebtedness, or the potential impact of acquisitions or dispositions that may be completed or occur after the date of the press release.

You may recall that we provided some data points on our website regarding the historical spread of our annual results by quarter. This is meant to be a guide and not a predictor. However, based on the year-end position of our core U.S. portfolio, we estimate our first-quarter 2014 EPS as a percentage of the full-year EPS guidance will fall below any previous first-quarter results in 2009 to 2013.

With that, Stephanie, we would be pleased open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Brad Thomas, KeyBanc Capital Markets.

Jason Campbell - *KeyBanc Capital Markets - Analyst*

This is Jason. I just wanted to give my congratulations to Mark on his retirement, and Robert on his new position.

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

Thank you.

Jason Campbell - *KeyBanc Capital Markets - Analyst*

I guess you guys had just walked through a couple of the line items, the gross margin and the expenses. Particularly with the expenses, I wonder if you can kind of go and expand on which of those are kind of ongoing. We may see them into the first quarter or first half of next year, and which of those are just kind of contained within the fourth quarter itself.

Robert Davis - *Rent-A-Center, Inc. - CFO and CEO Designee*

Well, Mike walked you through four of the items, $0.08 being a byproduct of the self insurance claims. We did see a large increase in the number of large claims in the fourth quarter relative to prior quarters. That also required a bump-up in our reserve given the trends that we were seeing in the fourth quarter. We are not expecting that run rate of claims to sustain that level, but the reserves we do anticipate staying at the level they are at. So, I would classify that one as primarily one-time in nature. Obviously, the severance costs are one-time in nature. The effective tax rate is one-time in nature, given the sale of stores to franchisees. And then the on-rent reserves, although they are one-time in nature in terms of topping up the reserve levels, we do anticipate there being a slight increase throughout the balance of next year, albeit a small amount. The majority of that $0.10 is one-time, but there's additional expectations of that continuing into next year, but in large part driven by the increase in business associated with RAC Acceptance. As the portfolio grows, you've got to increase the reserve as well, and so that's what I am referring to about the impact for 2014.

Jason Campbell - *KeyBanc Capital Markets - Analyst*

Okay. And then you guys have talked a lot about the macro. Have you kind of looked at how much you think is macro versus how much was, say, competition or loosening credit or weather related?

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

Yes, Jason. This is Mitch. I think the majority of it is certainly the consumer because we can look at different areas relative to competition, and it wasn't like we saw much of a difference at all in our numbers relative to where the competition is. Whether that competition is within one mile, two miles and so forth, we can cut the numbers a lot of different ways. And where the competition is doesn't pop off the page. So I think it's more about the headwinds of the consumer spacing. Weather, it's been a problem more in January than it was back in December, so no I don't think it was weather either when we think about the fourth quarter. I think it's certainly the headwinds of the customer.

Jason Campbell - *KeyBanc Capital Markets - Analyst*

And then lastly, you guys had talked about next year trying to drive more of the high-value offering. Can you kind of go into a little bit more detail on what you consider high-value and how you plan to kind of drive a higher mix of those products?

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

Sure. Let me start by saying -- I see you have the scope of it. When we talk about December being bad and how that rolls into next year relative to our guidance for next year, December was off roughly our portfolio. From an expectation standpoint, it's off about $3 million versus what we normally and in the past and what we expected it to grow in December. That $3 million in the portfolio business rolls all the way through next year unless we make it up at some point, and we don't have that factored into our model. That would be upside if we were able to make up that $3 million that didn't come in in December. So if --t hen that $3 million rolls each month, so $36 million for the year minus some depreciation costs, and you've got close to a $0.30 number dropping into the negative into the guidance next year just south of that one month. So that's (technical difficulty) one month either up or down can affect the business. So that rolls into 2014.

And as far as we think about the guidance that's out there now with that $3 million shortfall, and again we don't -- it's not like it's calculated in there to make it up, otherwise our guidance wouldn't have been as low as it is for 2014. When we think about how we're going to maintain the agreement portfolio above 2012's level -- and even with a bad December, we're still above 2012's level. Your question was how do we do that? What do we mean by high-value offering? So, certainly a lot of it has to do with packaging and putting items together to make a tremendous value for the consumer, but to get the ticket back to where it was or to at least maintain it where it is rather than another large drop in 2014 like we had in 2013. So, it's combining items. It's larger -- carrying more of the larger screen sizes on televisions, even stereos, larger stereos, even the furniture mix. You can carry more on the higher end, but make it a high value for the customer.

But I guess the short answer is the two main things are screen sizes from a television standpoint, certainly technology, more smart TVs versus non-smart TVs on the television side, and a whole lot of emphasis on packaging products together.

Robert Davis - *Rent-A-Center, Inc. - CFO and CEO Designee*

I would just add on that we were very deliberate last year in trying to recapture our portfolio that we fell behind on early in the year. And by that, we were -- you've heard us talking about being very promotional. And that promotional activity drove our ticket down.

This year, 2014, we're going to have less of an emphasis on being as promotional due to what we experienced with the ticket. So, the combination of not just the emphasis that Mitch mentioned on new product in packages, but also being deliberate about not being as promotional.

Jason Campbell - *KeyBanc Capital Markets - Analyst*

All right, appreciate it.

Operator

Laura Champine, Canaccord.

Laura Champine - *Canaccord Genuity - Analyst*

Good morning. My question is more on -- and I know you'll talk more about this in a couple of weeks -- but on the potential to go online with Acceptance Now. How would that work in terms of sourcing the product? Because we thought one of the reasons that the kiosk business works is because it's also beneficial to a retailer. How do you maintain that value proposition for your retailer partners if you go online?

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

It would be the same. It would still benefit the retailers because it would be going -- automating the process within the store where the customer is already. We just wouldn't be doing it manually or under that scenario with our coworkers in the store.

Laura, it really helps us get into stores that are too low of a volume to have a manned kiosk. It certainly helps us -- speed to market sooner. You can rollout so many more of them fast. But it's still in the retail store, so it still benefits the partner.

Now, there may be -- there may also be an opportunity to use the same software outside the store, but as far as the Acceptance Now business, it would still be inside the store and still benefit the retailer.

Robert Davis - *Rent-A-Center, Inc. - CFO and CEO Designee*

So Laura, just to provide some to additional insight on that, I mentioned in my prepared comments Sears, Kmart, Big Lots having services of similar ilk to our unbanked or underbanked consumer. And they're doing that through a virtual platform. There are small companies out there, why not lease it. You saw the press release for Sears and Kmart and Big Lots has progressed. And so there are other competitors in this virtual space.

We focused on demand opportunity, given the demand we saw in our pipeline. But now we also are going to be able to offer this virtual platform. It just broadens our appeal to a much larger group of retailers. So that's what we are referring to. It's not a virtual platform that people can enter into if they're home. It's actually still inside the retail location.

Laura Champine - *Canaccord Genuity - Analyst*

Got it. Thank you.

Operator

John Baugh, Stifel Nicolaus.

John Baugh - *Stifel Nicolaus - Analyst*

Thank you. And best wishes to you, Mark, in retirement.

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

Thank you.

John Baugh - *Stifel Nicolaus - Analyst*

I definitely wanted to start off with the building blocks on the comp. You guided 3.5% to 5%. If you walk me through the three pieces, how you think about that, and just that as a starter. Thank you.

Robert Davis - *Rent-A-Center, Inc. - CFO and CEO Designee*

The guidance for next year, obviously as Acceptance Now becomes a larger component of the overall revenue base, as they throw off larger comps, it has a more meaningful impact to the mix.

But the core U.S. business, given how December ended and how Mitch mentioned how that rolls through all of next year, we are not anticipating the core business being positive next year. It will be down slightly.

When you think about Acceptance Now and international, both of those will be significantly positive, similar to some of the numbers that we threw out in terms of this most recent quarter, international perhaps being a little bit higher than that just given, again, the size of the store base. So it's really that positive guidance that we gave is really being driven by our growth initiatives with the core business being down slightly.

John Baugh - *Stifel Nicolaus - Analyst*

And then how do international, Mexico specifically, the loss was greater this year than last year. And I know you talked about some incremental costs in going into Mexico City. But if we were to try to isolate the -- I don't know -- growth cost different in Mexico from what you've done previously, what kind of rate of lower losses or profit improvement did we see in 2013?

Mike Wilding - *Rent-A-Center, Inc. - SVP, Accounting, Controller, and Interim CFO*

If you look at the segment data in the press release, international lost $28 million in operating profit in 2013 compared to $31 million last year, so lost less in 2013.

Our guidance for 2014, we alluded to the fact that we expect $0.25 dilution. That implies an improvement over $28 million of several pennies, $0.06, $0.07, something in that range. And that's how we would think about going forward beyond next year too is that loss will continue to shrink, and we'll be net accretive year-over-year going forward.

John Baugh - *Stifel Nicolaus - Analyst*

I guess my question is, though -- is that loss shrinking because you pulled back on the amount of, if you will, new store drag, or are the existing operations improving as well?

Robert Davis - *Rent-A-Center, Inc. - CFO and CEO Designee*

It's a combination of both. That's a fair question. We are opening 35 stores next year as opposed to a larger number like this past year. And that depends on the timing of those locations throughout the course of a twelve-month period. But it's fair to say that the less loss is a combination of improvement in the operations as those stores continue to ramp, as well as fewer new stores. Mitch mentioned -- I don't know if it was emphasized enough or heard the emphasis on it, but our first division in Mexico in December, which is how many stores?

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

Half the country.

Robert Davis - *Rent-A-Center, Inc. - CFO and CEO Designee*

Half the country, 70-plus stores. Our first division made a net-net profit in December, fully loaded after overhead. That is obviously what provides us the comfort and confidence to continue to invest and build out that country.

John Baugh - *Stifel Nicolaus - Analyst*

Okay. And lastly, could you update us on the covenants, where you sit currently with the key covenants? I know there are several that tie to the bank line and capital expending, stock buybacks, so I don't know if it relates to dividends or not. But could you update us on that? Thank you.

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

Certainly. The leverage covenant I think most people know is 3.25 turns. Our leverage at the end of the year was about 2.6, and so we are still quite a ways away from that 3.25 covenant.

In terms of the revolver and debt capacity, we've got about $235 million of availability under the revolver at year-end.

And then in terms of share repurchase baskets, the board authorized amount is around $0.25 billion, $250 million. Given the leverage ratio at year-end, we do anticipate having to address that in the near term. As a reminder, the share repurchases, as long as senior leverages is 2.5 or less, you are not restricted. We are now over 2.5, so we need to address that in the near term.

John Baugh - *Stifel Nicolaus - Analyst*

And is there anything on the dividend and CapEx, any restrictions there as well?

Robert Davis - *Rent-A-Center, Inc. - CFO and CEO Designee*

The dividends would be similar to share repurchases. And so as I said, it needs to be addressed.

John Baugh - *Stifel Nicolaus - Analyst*

Great. Thank you very much.

Operator

John Rowan, Sidoti and Company.

John Rowan - *Sidoti & Company - Analyst*

Good afternoon everyone. Just to talk about Acceptance Now for a second, when you look at the store by store or the partner by partner results, do you see a distinct difference between partners that were heavily promotional through the holiday period versus the ones that were not specifically in the electronics retailers?

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

I don't have it by partner by partner in front of me. We probably wouldn't address that anyhow as far as how we are doing within each partner because that's really between you and the partner as far as how they did business in the quarter. So, we would just talk overall and not give out that information partner by partner anyhow.

John Rowan - *Sidoti & Company - Analyst*

What I'm trying to get obviously is some of your partners reported huge declines in same-store sales because they weren't promotional with some of their electronics items. I'm just trying to figure out how closely your Accept Now business tracks with those particular partners, and not one specifically, but just in general.

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

I don't have in front of me which ones were more promotional than others to even comment on that.

John Rowan - *Sidoti & Company - Analyst*

Okay. And then as far as the virtual platform, obviously there's been I don't want to say concern, but the kind of hole in the competitors platform has always been retail distribution of used items. How is your platform going to differ from what's already out there?

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

I think the fact that we can still -- there is still room to put used product in our core business to re-rent them is a tremendous advantage over our competitors in the virtual space. Also having the infrastructure of the -- that we already have out there for Acceptance Now for the manned kiosk is a big advantage. It will not just be an IT play for us. It will have the support of the whole Acceptance Now team on it as well as the support of the close to 3000 core stores behind it from not only taking the used product but helping in collections and things like that. So, it will be a tremendous and distinct advantage over what's currently out there for virtual.

John Rowan - *Sidoti & Company - Analyst*

Okay. Thank you very much, and good luck, Mark, in retirement.

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

Thank you.

Operator

Budd Bugatch, Raymond James.

Justin Santa Cruz - *Raymond James & Associates - Analyst*

Hi guys. This is Justin Santa Cruz on the line for Budd. I know the historical mix of new versus used merchandise is about 25% to 75%. I'm curious as to what the percent of the used merchandise is that came from Acceptance Now.

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

Our used percentage is a little higher than we'd like it right now, not so much because of Acceptance Now. Products coming in from Acceptance Now in our core business as we track that, it rents at a very similar pace to what we ourselves put in the core business. It doesn't fall behind that. So that's really not the problem.

But when you have a soft quarter or a soft month, primarily December, we ended up with a little higher mix of used product than we would like in the store. I wouldn't blame it on Acceptance Now. I'd blame it on business being soft. It's probably 3 or 4 percentage points higher on the used or lower on the new, however you want to say it, comp where we would like to be. So we are working hard on that to get that back where we want it. That's a key metric for us.

Justin Santa Cruz - *Raymond James & Associates - Analyst*

Okay. And has the kind of 25% return rate for Acceptance Now, has that changed at all?

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

No, it's running between 20% and 25%. That metric hasn't changed at all.

Justin Santa Cruz - *Raymond James & Associates - Analyst*

Okay. I'm just wondering if you could explain a little bit better for myself what exactly the on-rent reserve is?

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

Given, in our business, we don't really have receivables, i.e. the revenue we recorded over the life of the contract as opposed to being all booked up front, a traditional retail sale, if you will, the losses that we incur is as the book value of the product that we write off when we can't collect on the merchandise or the customer doesn't return it to us. So we have to reserve for what those potential losses will be going forward and maintain that on our balance sheet. So we did have to increase the amount of that reserve during the quarter.

Justin Santa Cruz - *Raymond James & Associates - Analyst*

Okay. And you said that was about $0.10 worth in this quarter.

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

That's correct.

Justin Santa Cruz - *Raymond James & Associates - Analyst*

And so do you think that could be a couple of cents going forward? I know you mentioned it would be smaller, but --

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

Yes, I think we've got $0.04 or $0.05 in next year's forecast for that.

Justin Santa Cruz - *Raymond James & Associates - Analyst*

Okay.

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

And again, that's largely driven by the growth of Acceptance Now. As the portfolio builds and the number of contracts go up, you have to have a corresponding increase to the reserve to accommodate for that growth.

Justin Santa Cruz - *Raymond James & Associates - Analyst*

Okay. Thank you very much for the questions.

Operator

Barry Haimes, Sage Asset Management.

Barry Haimes - *Sage Asset Management - Analyst*

Thanks very much. I appreciate all the things you outlined in terms of trying to improve the business from here. But I had a question of two kind of going back to the core customer. And what do you think is driving the recent weakness? Because we are pretty far away from things like the payroll tax increase and the Washington DC angst that maybe were issues earlier in 2013.

And secondly, when you're trying to gauge when you might see a turn, are there any macroeconomic indicators or other things you look at to kind of keep the pulse on your core customer?

And then third and last point on this is you alluded to the fact that the core business comp would be slightly down in 2014. And will that look relatively even as we go through the year, or does it start out weaker and it needs to reflect better at some point in the year, and if so when that might that be? Appreciate that. Thanks.

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

You raise a fair point in regards to the core customer. And I think that's a question that many people are struggling with. But trying to associate us with other folks that struggled in the fourth quarter as well, we've got our own challenges. But I think that whatever we would speculate about December would be just that, speculation in terms of the customer. We are far away from the payroll tax increase. We are far away from the delayed income tax refunds. So I would just be speculating. I don't think that's what we need to do.

We laid out for you what we think we need to do to improve our business and that's what we are going to be focused on. At the end of the day, putting the customer at the forefront of everything we do, and trying to serve them from a world-class perspective. And so to talk specifically about what occurred in December within our customers' behavior and pinpoint that on the macro environment, it would be pure speculation and I don't think that's a worthwhile exercise.

In terms of the comps, there is some expectation that that ramps during the course of the year. Given where we ended the quarter, I think the comp in the core business was down 5.5% or something in the quarter. So, that's where we are starting from. And to be down slightly implies that through the balance of the year there would be improvement to that run rate over the course of 2014.

Mike Wilding - *Rent-A-Center, Inc. - SVP, Accounting, Controller, and Interim CFO*

I would add to that, as far as gauges, you also asked about gauges going forward. Again, without trying to assign exactly what happened to the customer in December, there are a few things we know will help us when they happen. Lower unemployment certainly helps us. Consumer confidence, and I'm not talking about overall consumer confidence trends that are built sometimes by the housing market or the stock market. I'm talking about consumer confidence with the lower middle income consumer that we do business with. So those are two of the best gauges for us, consumer confidence, lower unemployment, certainly some wage growth along the way. But that kind of comes with lower unemployment.

Barry Haimes - *Sage Asset Management - Analyst*

Appreciate that. Thanks so much.

Operator

Carla Casella, JPMorgan.

Paul Simenauer - *JPMorgan - Analyst*

This is Paul Seminour on the line for Carla Casella. I just have one question for you guys. Have you talked to the rating agencies at all, and do you think that you guys could be downgraded? Thank you.

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

We have not talked to the rating agencies, and I wouldn't speculate on how they would view our current results.

Paul Simenauer - *JPMorgan - Analyst*

Thank you.

Operator

Janet Clay, Liberty Mutual.

Janet Clay - *Liberty Mutual Insurance Group - Analyst*

You mentioned that you were going to need to address that leverage test. What do you have in mind doing for that?

Robert Davis - *Rent-A-Center, Inc. - CFO and CEO Designee*

Well, obviously, we've got to address our ability to continue to pay dividends on an ongoing basis, given senior leverage is over 2.5 times. And then what that looks like in terms of how we would propose to restructure the balance sheet is being evaluated. It could take on one of several different forms, and we don't have a final response to that at this point in time.

Janet Clay - *Liberty Mutual Insurance Group - Analyst*

Okay, thank you.

Operator

[Yu Jose, Roy and Advisers].

Yu Jose - *Roy and Advisers - Analyst*

Could you guys just talk about, give some color on the restatement that you guys made for fiscal 2012, and how that occurred -- was it more internal controls issue, accounting related; and how that overstated your on-rent merchandise?

Mike Wilding - *Rent-A-Center, Inc. - SVP, Accounting, Controller, and Interim CFO*

I'll walk through that. This is Mike. As we went through the 2013 audit process with our external auditors, we determined that our reserves for the skipped/stolen merchandise, which, as Robert explained earlier -- it was not at the appropriate level now or in prior years.

So with actual data and with the benefit of hindsight, we went back several years and compared actual write-offs of merchandise against the reserves that we had on the books at the time. We reset the reserves and then marched that forward, rolled that forward to the end of 2013.

So we did footnote in the press release, as you mentioned, that the impact for the 3 months and 12 months ended 2012 was noted there in the press release. And then just the top-up in reserves that we talked about for 2013 is also an impact of that adjustment -- the impact of rolling that reserve forward.

Yu Jose - *Roy and Advisers - Analyst*

Okay, great. And then one more question, if I could. Your average inventory on rent has been increasing over the past several quarters by a material amount, and then -- but your average depreciation rate has been declining. And now I would think as your merchandise on-rent and held for rent -- both held for rent have also been increasing. How come the revision isn't tracking the inventory trend?

Mike Wilding - *Rent-A-Center, Inc. - SVP, Accounting, Controller, and Interim CFO*

Well, remember, we grew -- we have more agreements on rent at the end of 2013 and of 2012. So that's why there's more inventory on rent. It's been -- as me and Robert have both pointed out, it's heavily promotional to get those on rent so that revenue didn't come with it, but that -- the inventory shows the fact that we got more on rent. We just were so heavy getting it out there and gaining market share through promotions that it didn't translate to revenue. It is certainly at a high enough level; it certainly translated to a lot of revenue, just not enough.

Yu Jose - *Roy and Advisers - Analyst*

Got it. So you guys are guiding for depreciation to increase in fiscal 2014?

Mike Wilding - *Rent-A-Center, Inc. - SVP, Accounting, Controller, and Interim CFO*

Are you referring to rate or dollars? I'm not sure if you're looking at segment data or consolidated data. I only mention that because on-rent is also going up pretty dramatically, given Acceptance Now; and Acceptance Now carries no inventory, given the fact that the sales come through the retailers -- the inventory in the retail locations.

So on-rent on a consolidated basis is going to look distorted compared to prior years as Acceptance Now grows. The rate of depreciation percent -- if you're looking at gross profit dollars and putting in percentage to that, there are some changes that we made to our pricing relative to our EPOs and cash sales.

We are seeing a benefit of that during the course of 2013. So as we look to 2014, we would expect depreciation percent or cost of goods sold, if you will, to be slightly flat to moderately down given the continuation of increase in RAC Acceptance or Acceptance Now. There's a lower margin of gross profit in Acceptance Now.

Yu Jose - *Roy and Advisers - Analyst*

Thank you very much.

Operator

Adam Silver, Babson Capital Management.

Adam Silver - *Babson Capital Management LLC - Analyst*

Two quick questions here. First, I think you said 2013 operating cash flow is $135 million, and for 2014 guidance you said it would be negative $65 million, largely predicated on taxes. Wondering if you could walk through that a little bit more? And then have you guys have seen any evidence that the pool of underbanked has shrunk as the economy has improved, and there's more banking options made available to them?

Robert Davis - *Rent-A-Center, Inc. - CFO and CEO Designee*

So I'll take the cash flow one first. In regards to the guidance that we gave -- negative $65 million, I think it was, that Mike mentioned -- there is an additional tax obligation in this year's forecast that's about $85 million. Without that we would be cash flow positive roughly $20 million.

That's obviously down from our historical run rates, and in large part due to EBITDA being down. So our focus is turning that tide and turning that trend around, increasing the EBITDA, and the cash flow will then -- will follow suit. But 2014's forecast being down would be positive if it weren't for the turnaround in our tax liability.

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

On your question about the pool of underbanked consumers: no, we are not seeing any evidence of that shrinking based on the economy getting better overall. Or maybe getting better at the higher end, at least.

And I say that, keep in mind, we did rent -- we did more deliveries in 2013 and 2012 in the core business, and at the end of the year we have more agreements on rent than we did at the end of 2012. And our store count stayed very similar.

So we have got more on rent. The deflation in the electronics and our own promotional schedule is what drove the revenue down, as well as the lower early-purchase option exercised by the consumer. So consumer-wise, deliveries for the year and the agreements at the end of the year are higher than 2012. So no, we are not seeing that shrink.

Adam Silver - *Babson Capital Management LLC - Analyst*

Thank you very much.

Operator

TJ McConville, Becker Capital.

TJ McConville - *Raymond James & Associates - Analyst*

Before I get into the questions, let me add my congratulations to you, Mark, on retirement.

I have a couple of questions about, first, the charges in the quarter. Mike, you outlined the after-tax amounts. If I look at those numbers, and then I back out that big amortization charge in the quarter, I get somewhere in the neighborhood of $30 million pretax that is sort of one-time in nature. Is that a fair enough number?

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

Trying to get the math here, TJ, because we said about 30% -- Mike said about 30% was gross profit. And then that 70% is primarily made out of things that are similar to one-time charges. That would be about $0.35.

So yes. I think we've talked about the majority of it. And there's a penny here, a penny there that -- we are not getting down to that detail. But I think that's about right.

Mike Wilding - *Rent-A-Center, Inc. - SVP, Accounting, Controller, and Interim CFO*

What threw me off there was -- when you said amortization, were you referring to? Because it could --.

TJ McConville - *Raymond James & Associates - Analyst*

Well, there's the amortization in write-down -- the write-down when you sold the stores to the franchise --.

Mike Wilding - *Rent-A-Center, Inc. - SVP, Accounting, Controller, and Interim CFO*

Yes, okay. Okay.

TJ McConville - *Raymond James & Associates - Analyst*

So is there any way that you might be able to allocate that by segment, just so we can get a sense for the profitability here? Because to your point, Mitch, the RAC profitability excluding that would have been up year over year, but we are seeing it as down year over year. So any help you could offer maybe on that reserve line would be helpful.

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

You're talking about Acceptance Now on the segment. It was still certainly up year over year, even for the quarter. That $15 million -- roughly $15 million in the fourth quarter would have been about $18 million without that top-up on the reserve versus $10 million in 2012. And then for the year it's up by over $40 million, even with the top-off.

So -- but I can tell you this, that when we talked about -- Mike talked about 30% of the problem or so being gross profit, and that $0.17, and about 80% of that was core and about 20% Acceptance Now. As Mike says, $0.13 on the core and $0.04 Acceptance Now. Mostly insurance claims were on the core, but it would be probably 2 to 1 core to Acceptance.

Most of the on-rent merchandise reserves were in Acceptance. Well, no, that was about half-and-half, also; when you think about actual losses, the core did run at the high end of our historical norms for losses. I'd call that half-and-half. Severance was probably all in the core. So does that help, TJ, that kind of breakout?

TJ McConville - *Raymond James & Associates - Analyst*

That's great, Mitch. I'm just trying to get a sense for the individual segment profitability and how close to target you are.

The second question I have goes more to the guidance. I'm having a hard time kind of getting to the lower end of the range, which would kind of imply down earnings, with revenues up 4.5% to 7.5% with what ought to be an improving revenue mix, with the contribution of Acceptance Now getting bigger and less drag in the international business. So can you talk about what's built into that earnings guidance that could get you actually down earnings next year on that kind of sales increase?

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

We still have that core forecasted to be down. Not the 5% or 6% it was down this year, but slightly down. So on the revenue growth that is coming from the new businesses, it takes a while for those new businesses to outrun their expenses.

There's also some -- there's also new stores in there: 100 Acceptance Now and 30 or so stores in Mexico. So when the growth coming from the new initiatives, it's not as good of revenue growth as it is if the mature business puts on revenue growth and you get 40% or 50% pullthrough.

I think the short answer is the core still being down slightly in 2014 is what you have to keep in mind to tie it to the earnings guidance.

Robert Davis - *Rent-A-Center, Inc. - CFO and CEO Designee*

And that's the largest portion of the revenue base. So if the largest portion is negative, it's going to a large impact on the expected outcome overall.

TJ McConville - *Raymond James & Associates - Analyst*

Okay. Understood. And the last one for me, then, is sort of to that point, and to your point, Mitch, a minute ago about deliveries being up and on-rent being up. This is the first quarter since last year's fourth quarter that the on-rent merchandise number in the core business is up sequentially.

And coming into this year we don't have the same comp issue that you had last year's first quarter. So I'm just trying to get a sense for the expectation of down for the full year, even though you've got those earning assets out there at a higher level than previously.

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

The actual -- the assets are out there at a higher level. Ticket is down 4% or 5% year over year. So the fact that we got those assets out there, being heavily promotional, as well as deflation in the electronic side -- TVs and computers, we've got it. We will be fine, like we said, as long as 2014, we don't -- we can keep that agreement portfolio above last year's level without dropping the ticket any more, by promoting differently, packaging better, and addressing our offerings a little bit -- what we offer the customer.

TJ McConville - *Raymond James & Associates - Analyst*

Thanks for the questions, guys. Best of luck on 2014.

Operator

Bill Baldwin, Baldwin Anthony Securities.

Bill Baldwin - *Baldwin Anthony Securities Inc. - Analyst*

Just kind of a housekeeping item here. When you look at your breakdown by divisions, I was just looking here at the core division. When you actually calculate your gross profit margins here in the fourth quarter versus a year ago, they're showing a slight actual increase on a percentage basis. So when you indicate a shortfall in gross profit, are you just talking gross profit dollars? Is that what you're referring to?

Mike Wilding - *Rent-A-Center, Inc. - SVP, Accounting, Controller, and Interim CFO*

No, Bill, I was talking about consolidated gross profit percent. As Acceptance Now increases, it has an impact on our consolidated gross profit percent. But you're right; the core is up, and I was alluding to earlier in terms of how we changed some of our pricing on our EPOs and merchandise sales -- that has had a positive impact on our margins in the core segment.

Bill Baldwin - *Baldwin Anthony Securities Inc. - Analyst*

That's right, okay. I hear you. Yes, your merchandise sales are included in that divisional breakdown. Okay. Thank you much.

Operator

Jordan Hymowitz, Philadelphia Financial.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

Thanks, guys. And Mark, congratulations on doing a very good job. People forget you came back and took the Company from near disaster, redeveloping a lot when you came back as CEO. So good job there.

Question: can you break out the 2.9% charge-off number between the RAC Acceptance and the core business?

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

When I said 2.9%, Jordan, I was only referring to the core. So that is the core business.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

Okay. What is the number, then, on the RAC Acceptance?

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

I don't have that in front of me. It will be in the Q. I can tell you that our losses in Acceptance and in the core business from a customer standpoint -- a ratio of accounts we write off relative to the accounts we have on rent is -- they run right on top of each other month after month.

When we do report the percentage of losses in Acceptance Now versus core, it will be a little higher, because we paid more for the merchandise. So when you take the value of the merchandise relative to monthly income -- not overall income -- but we take the value of the merchandise relative to monthly income, the percentage runs a little higher in Acceptance Now because we paid more for the product. But as far as the actual customer behavior, they run right on top of each other.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

So you are saying from a frequency point of view, they have the same incidence of loss, but the severity is higher?

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

Well, the severity is higher, yes. Because we paid more for the product. That's correct.

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

You're paying retail versus wholesale.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

If you would approximate -- if the 2.9% would equate to what approximately, then, if the severity is high? Would be 3.2%, 3.3%?

Mike Wilding - *Rent-A-Center, Inc. - SVP, Accounting, Controller, and Interim CFO*

I don't have those in front of me. I think it's a little higher than that, because we are paying -- we are paying more, like 50% more for the product by paying retail. So I think it's higher than the low 3s.

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

When you look at it that way. Again, but frequency runs very consistent between the core and Acceptance Now.

Operator

I'm showing no further questions in the queue at this time. I'll turn the call back over to Mr. Speese.

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

Ladies and gentlemen, thank you again for joining us this morning. I'll conclude, I suppose, my opening comments, first expressing our disappointment with the final month, quarter, and the year itself. Clearly disappointed.

At the same time, as I hope you heard and as we are very excited to share with you in two weeks in New York, we believe we've got some very well-defined strategies, initiatives, in place that are going to address not just the near term but continue to provide tremendous opportunities for the Company in the long term. We are excited to be able to spend the afternoon or the better part of the day with you in two weeks and go through those in-depth, providing color as to the things that we will be working on and the opportunities that are available for the Company to continue to move forward.

At the same time, I want to tell you: it's been an honor and a privilege. I appreciate all the support that you have all given me over the years. It's been a humbling experience.

Again, I am excited to stay involved. I am still a large shareholder and aligned and will continue to play a role, simply from a different perch. But I've got a tremendous amount of confidence in the management team that's here and their ability to continue to move the Company forward for the benefit of all of us.

And again, we look forward to sharing that with you, again, in a couple of weeks. So as always, we appreciate your support. We appreciate your interest. We look forward to seeing you in a couple of weeks and reporting back to you next quarter. Thanks again. Have a great day.

Operator

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