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RCII - Q1 2017 Rent-A-Center Inc Earnings Call

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**OVERVIEW:**

Co. reported 1Q17 consolidated total revenues of $742m and net diluted EPS, excluding special items of $0.04.





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## CORPORATE PARTICIPANTS

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**Maureen B. Short** *Rent-A-Center, Inc. - Interim CFO*

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## PRESENTATION

**Operator**

Good morning, and thank you for holding. Welcome to Rent-A-Center's first quarter earnings release conference call. (Operator Instructions) As a reminder, this conference is being recorded, Tuesday, May 2, 2017.

Your speakers today are Mr. Mark Speese, Chief Executive Officer and Chairman of the Board of Rent-A-Center; Maureen Short, Interim Chief Financial Officer; and Daniel O'Rourke, Vice President of Finance, Investor Relations and Treasury.

I would now like to turn the conference over to Mr. O'Rourke. Please go ahead, sir.

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**Daniel B. O'Rourke** - *Rent-A-Center, Inc. - VP of Finance Analytics & Reporting*

Thank you, Zetania. Good morning, everyone, and thank you for joining us. Our earnings release was distributed after market close yesterday, which outlines our operational and financial results for the first quarter of 2017. All related materials are available on our website at investor.rentacenter.com.

As a reminder, some of the statements provided on this call are forward-looking statements which are subject to many factors that could cause actual results to differ materially from our expectations. Rent-A-Center undertakes no obligation to publicly update or revise any forward-looking statements. These factors are described in our earnings release issued yesterday as well as in the company's SEC filings.

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

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**Mark E. Speese** - *Rent-A-Center, Inc. - Co-Founder, Chairman and CEO*

Well, thank you, Daniel. Good morning, everyone, and thank you for joining us. Today, we'll discuss our first quarter results and we'll also provide an update on the progress that we're making on our new strategic plan that we announced a few weeks ago, designed to drive growth, improve profitability and deliver enhanced value for all of Rent-A-Center's stockholders.

These initiatives include strengthening the Core U.S. business, optimizing and growing the Acceptance Now business and leveraging technology investments to expand distribution channels and integrate our retail and online offerings. But first, let me provide an overview of our first quarter performance.

During the first quarter of 2017, we delivered sequential improvements in nearly all of our key operating metrics. Specifically, we remain encouraged by our quarterly improvements and consolidated total revenue, same-store sales, delinquencies, inventory management and coworker turnover, all of which demonstrated the progress that we are making on our strategy.

As expected, on a year-over-year basis, we experienced the decline in revenues, gross profit and operating profit. This was driven primarily by declines in same-store revenue, which resulted from the challenges that we experienced in the second half of last year, and a reduction in our store base for the Core U.S. segment, partially offset by improvements in revenue and gross profit in the Acceptance Now segment.

Importantly, we want our stockholders to know that we believe that the actions that we have already taken as part of our strategic plan are helping to stabilize our performance, as demonstrated by our consistent, sequential improvements.

You've heard me say, given the portfolio nature of the rent-to-own business, it will take some time to fully realize the benefits of the strategic plan. We are encouraged by our performance and are confident that there are more good things to come as we fully execute on our initiatives.

Turning now to the U.S. Core business, the quality of the portfolio improved during the quarter and the size of the portfolio gained ground versus the prior year period, even with a higher count of early purchase options caused by the higher promotional activity in 2016.

We also made significant progress in the quarter on the efforts outlined in our strategic plan to strengthen the business. We implemented a new comprehensive offering in February, aimed at increasing demand and retention through shortened terms and an increase in the early payout discount.

This offering lowers the cost of ownership for our customers and improves our return on product investments. It's also one example of how we are enhancing our customer value proposition and creating a clear path to ownership that better reflects the needs of our customers, retention rates and the life -- natural lifecycle of the inventory. This will help increase ownership, accelerate the inventory turns and improve our cash flow.

As part of our initiative to optimize our core product mix to better meet the customer demand, we've also begun shifting the concentration of higher and aspirational products across categories, from the 45% to 65%, which will ultimately drive higher ticket and improved economics.

Now while it will take a couple quarters before these higher and aspirational products once again become a meaningful portion of the inventory mix, the process has begun, and we have made big strides in rightsizing our idle inventory up for rent, and in fact, our monthly delivery rate is beginning its move upward.

To accelerate the product mix optimization, we have also aggressively implemented several initiatives to reduce the amount of Acceptance Now returned product into our core stores. These efforts include increasing sell-through rates by reducing the remaining inventory value of Acceptance Now products when they are transferred into the core, and targeted initiatives to reduce the Acceptance Now returns overall.

As part of our initiatives to stabilize and upgrade our U.S. workforce, we've developed and implemented an iterative and more focused approach to training and development that will enable consistent execution and strengthen customer relationships.

When we announced our strategic plan, we know that we believed our renewed focus on developing employees would increase retention and stabilize the workforce. We are pleased to report that the trajectory of coworker turnover remains well ahead of last year.

We also made progress to improve our account management in the Core U.S. business to lower delinquency rates by focusing on training, tools and incentives to restore store level execution issues. The quality of the portfolio improved every month in the quarter, and these are the lowest delinquency rates that we have seen in 3 years, the further evidence by lower expected losses going forward.

We'll continue to drive further improvements in our account management practices as well.

Optimizing our brick-and-mortar footprint is another strategic initiative in the Core business. As we have stated previously, our brick-and-mortar footprint provides critical support to our Acceptance Now and e-commerce operations and this footprint will be increasingly utilized as a hub for e-commerce fulfillment.

Additionally, any underperforming stores that do not show signs of a turnaround throughout the year will be evaluated for rationalization.

Throughout the quarter, we also saw significant progress in our Acceptance Now business, driven by an increase in same-store sales, a favorable sales mix and our increased focus on driving profitable sales, including our efforts to optimize our key retail partnerships.

We also took a number of actions in our Acceptance Now business to build on recent successes, drive further growth and further enhance profitability as outlined in the strategic plan.

One of the Acceptance Now initiatives we outlined in our strategic plan is optimizing key retail partnerships to deliver improved service and profitability, and we've made significant progress on this initiative in the first quarter.

In February, we announced that we are now the exclusive no-credit-needed-payment option for Rooms To Go, which will strengthen our already strong partnership with America's #1 independent furniture company.

Home furnishings have been largely resilient to the volatility in the broader retail market, and we believe that this partnership will drive value for our customers and our stockholders.

We are also pleased to report the early results and feedback of the national pilots that we announced on our last earnings call and we look forward to sharing more about these exciting agreements as time progresses.

Optimizing our Acceptance Now retail partnerships also involves exiting partnerships that no longer makes financial sense, in addition to building the strong pipeline of new partnership opportunities.

In the first quarter, we improved the Acceptance Now retail concentration by reducing our exposure to Conn's, one of the largest multilined Acceptance Now retail partners, which will make our Acceptance Now business less susceptible to volatility in the broader retail industry going forward.

As you may recall, in late March, we determined not to renew the agreement due to the quality and performance of customer accounts originating from Conn's stores, which consistently underperformed compared to the rest of our Acceptance Now segments in terms of delinquencies, losses and product returns.

While this action may negatively impact our revenue over time, it will ultimately help us optimize our portfolio of Acceptance Now locations and improve profitability and cash flow.

The final pillar of our strategic plan is leveraging investments in digital capabilities that will enable a seamless customer experience across channels, markets, retailers, products and brands.

To this end, we are extending our digital channels to help our customers engage when and where and how they prefer, with launches beginning next quarter. We will continue to develop these digital capabilities, and you will see a much richer engagement from Rent-A-Center in the coming months.

Before concluding my remarks, let me just provide a brief update on our franchise business in the Mexico segment.

We continue to believe that the person-to-person relationships that form the foundation of the brick-and-mortar rent-to-own transactions is particularly well-suited to franchising. We have started a process to commission an external consultant to create a plan for franchising brick-and-mortar as part of our overall corporate strategy.

Much to do and more to come, but we're excited about the opportunity. Additionally, throughout the first quarter, we are continue to be pleased with the growth and direction of our Mexico business, and we continue to evaluate our best path forward there as well.

As you heard me say before, I truly believe in Rent-A-Center's mission to provide the cash and credit constrained consumers with affordable and flexible access to durable goods that promote a higher quality of living. I continue to believe in the ability of this company and its coworkers to deliver on this mission through execution of our strategic plan, which is renewing our focus on what made Rent-A-Center an industry leader for decades and creating value for all of our stockholders.

As one of the company's founders and a large stockholder with a strong vested interest in growing stockholder value, I'm highly committed to improving our performance and driving long-term success. And I know I speak for all of us at Rent-A-Center when I say I'm excited about what is to come.

I do want to acknowledge and thank all of our 20,000 coworkers for their commitments and efforts during this past quarter as well.

And with that, I will ask Maureen to provide you more detail on the results of the first quarter. Maureen?

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**Maureen B. Short** - *Rent-A-Center, Inc. - Interim CFO*

Thanks, Mark. Good morning, everyone. Now I'll walk through the financial performance of the first quarter of 2017, and will present the results excluding special items compared to the same period of last year or to the fourth quarter of 2016, as we measure sequential improvement against our near term strategy.

Consolidated total revenues for the first quarter were $742 million, down 11.2% versus last year. Adjusted EBITDA was $33.3 million, which is at $23.4 million from Q4, and EBITDA margin improved 300 basis points sequentially, driven to what -- primarily by lower operating and corporate expenses.

Net diluted earnings per share, excluding special items, was $0.04, up $0.27 from Q4. In our Core U.S. segment, total revenues were down 16%, driven by a same-store sales decline of 12.5% and an 8% reduction in store count.

The same-store sales decline is primarily due to a lower portfolio balance and a lower average ticket versus last year. Given that the portfolio nature of the business, it will take time to recapture what was lost from the back half of 2016, but we do expect to improve same-store sales sequentially every quarter of 2017, and to achieve positive same-store sales in the fourth quarter as we continue to realize the benefits of our initiatives.

Core U.S. same-store sales improved sequentially by 140 basis points in the first quarter, and the portfolio balance improved relative to last year, since our agreement churn was lower than expected, even with higher early purchase options.

Gross profit margin in the Core U.S. business was 68.8%, 170 basis points lower than a year ago. In order to accelerate the transition through our optimal product assortment, we have implemented targeted pricing actions to right size the inventory mix and move through older, idle product more quickly.

Although these actions cause near-term pressure on gross margin in our monthly rental rate for the next couple of quarters, they will accelerate the transition to our optimal product mix.

We are pleased with the progress made and saw a 9.5% decrease in the amount of inventory held for rent since Q4 and a $64.8 million decrease versus the first quarter of last year.

Store labor expense was down $17 million and other store expenses were down $16.4 million versus the prior year, driven by store optimization efforts, which are expected to continue until Q2 when we start to comp over the benefits from the store closures that occurred in late Q2 of 2016.

Store coworker turnover was down 10.4 percentage points year-over-year, and delinquencies are at the lowest levels in 3 years.

Skip/stolen losses were 3.1% in the quarter compared to 3.5% last year, and our expectation is that losses will continue to improve, given the lower delinquency rate and the improved quality of the rental portfolio.

Core EBITDA dollars improved 9.7% sequentially, and EBITDA margin improved 40 basis points.

Now turning to the Acceptance Now business. Total revenues increased by 1.8% due to higher same-store sales of 2.9%, which were partially offset by a lower store count.

Acceptance Now inventory on rent increased $26.2 million or 8% due to higher purchase volumes in our retail partner location.

Gross margin was 48.8%, up 60 basis points from last year, driven primarily by a favorable revenue mix.

Acceptance Now EBITDA was $31 million in the first quarter, a 2.6% increase versus last year, and EBITDA margin increased by 10 basis points. Sequentially, Acceptance Now EBITDA increased by $10.7 million and EBITDA margin increased by 270 basis points, driven primarily by sales leverage.

Skip/stolen losses were 9.4% versus 9% last year, which is a significant improvement in year-over-year performance compared to Q4.

With the termination of the Conn's relationship, losses in the overall quality of our rental portfolio are expected to improve.

In Q1, 108 Acceptance Now locations were closed, primarily due to H.H. Gregg's previously announced store closure plans prior to declaring bankruptcy.

Within Q2, the remaining 128 H.H. Gregg stores will close as well as the 115 Conn's locations.

During Q1, the company made the decision to close 381 direct or unstaffed Acceptance Now locations in order to reduce costs and focus on optimizing our direct model. Anticipated improvement to the model include a better front-end customer experience, adjusted decision engine logic and reduced losses.

We believe that an unstaffed model is critical to providing retail partners with the ability to maximize sales during peak hours using the staffed model, while offering a lower cost and more profitable Acceptance Now solution for nonpeak hours in lower volume locations.

By reducing the direct store count at this point, we can better focus efforts on optimizing the model and ensuring we have a profitable and scalable direct model with the faster speed to market in the future.

We will be the only RTO operator in the industry that can offer a retail -- a retailer, a staffed or unstaffed model.

At the end of the first quarter, we had $58.1 million in cash and cash equivalents, and reduced total debt by approximately $72 million during the quarter. Our total debt balance was $663 million, with $70 million drawn on our revolver.

The bank group under the company's existing credit facility waived compliance with covenants for the first quarter and the company is in the process of obtaining an amendment to the existing credit facility, which is expected to provide covenant flexibility. We expect that the amendment will provide sufficient liquidity and flexibility to execute Rent-A-Center's strategies.

With that, let me turn the call back over to Mark before we open the line for your questions.

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**Mark E. Speese** - *Rent-A-Center, Inc. - Co-Founder, Chairman and CEO*

Thank you, Maureen. Before we open the call for questions, I would like to briefly discuss Engaged Capital's recent investment in the Rent-A-Center stock.

As you may know, Engaged has begun to solicit proxies in an effort to elect 3 individuals to the Rent-A-Center Board of Directors and to ultimately force the sale of the company.

Our Board of Directors, management team and advisers are unanimous in the belief that executing our strategic plan will deliver substantially more value to stockholders than conducting a sale process at this time. The board is prepared to execute its strategic plan expeditiously and with a high degree of confidence, and believes that the plan will restore growth and profitability for the benefit of all Rent-A-Center stockholders.

As I outlined in my earlier remarks, we have already made significant progress. Your board unanimously recommends that stockholders vote for Rent-A-Center's 3 candidates, including myself, Leonard Roberts and Jeffery Jackson, for the 3 Class II Director positions to be elected at the company's Annual Meeting, which is a vote in favor of a board that is committed to acting in the best interest of all stockholders.

To be clear, the Rent-A-Center board and leadership team welcome constructive dialogue with stockholders. However, we are concerned that Engaged is attempting to advance its own self-interest rather than the interest of all stockholders.

For additional information regarding the upcoming Annual Meeting as well as the board's recommendations, we refer you to our definitive proxy statement that we filed with the SEC and mailed to our stockholders of record as of April 24, 2017.

Before turning the call over for questions, I want to note that this all we'll be saying about this matter on today's call. The main purpose of our call today is to discuss our earnings results and our progress on executing our strategic plan. We ask that you keep your questions focused to these topics.

With that, I would like to now turn the call over for Q&A.

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) And your first question comes from the line of Budd Bugatch with Raymond James.

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**David Vargas**

This is David Vargas on for Budd. First, I want to start with question around Core -- the Core business and labor, you mentioned you started adding labor back to the stores and reducing some of the part-time employees. It looks like labor costs for store was down just under 3% year-over-year for the quarter. Just wondering if you can reconcile that with the decision to add back labor.

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**Maureen B. Short** - *Rent-A-Center, Inc. - Interim CFO*

Sure, thanks for your question, David. This is Maureen. We -- yes, I spoke in my prepared comments about the benefits that we're receiving in the first half of this year from the store closures that were done in the latter half of the second quarter of 2016. So while we are making investments in our frontline coworkers, in the front half of this year they will be offset by the benefits from the store closures of last year. In the back half of 2017, we will start to see the labor investments come through as we comp over those benefits from the store closures. However, as we've outlined in our strategic plan, we believe that the labor investment will be more than offset by the improved execution in top line performance that we expect to see from a more talented coworker base, and providing a more favorable customer experience.

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**David Vargas**

Okay. And then, on Acceptance Now, there's a pretty big increase, both sequentially and year-over-year in merchandise held for rent. Can you talk about what drove that? And is there -- is it going to be -- is there a plan to transfer any of that to the Core store for resale? And what's the impact going to be on the gross margin for Acceptance Now, if that is to take place?

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**Mark E. Speese** - *Rent-A-Center, Inc. - Co-Founder, Chairman and CEO*

You're right, the held for rent and Acceptance Now is up -- not quite $4 million year-over-year, and part of that was a conscious decision to slow the influx of the inventory into the Core stores, the back end of March, as we were doing the transfer pricing, wanting to right size the inventory that was already in the course so that we could more quickly push it through, before we kind of released it, if you will, and started to move this back. I can tell you that the returns in Acceptance Now have reduced in a meaningful way. You can expect to see by the end of the second quarter that held for rent will be back to more normalized or perhaps even below what you may have seen previously, now that we're moving it back through normal channels. That was just a timing issue as we were addressing what was already in the system.

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**David Vargas**

Got it. And -- but that move under the new transfer pricing decision will have an -- more of an adverse impact on the gross margin to Acceptance Now when it's transferred than in the past, is that correct?

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**Maureen B. Short** - *Rent-A-Center, Inc. - Interim CFO*

We will, for internal purposes, be writing down the product to wholesale cost levels, when it makes its way into the Core business. However, we do expect to continue to move through the inventory. And as we push more product through to the Core business, we feel like we'll be able to move through it faster because the stores will not be a gross margin impact at that store level.

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**Mark E. Speese** - *Rent-A-Center, Inc. - Co-Founder, Chairman and CEO*

On a consolidated basis, we don't expect any degradation of the gross margin line on a consolidated basis.

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**David Vargas**

Got it. Understand that, I was just talking form the Acceptance Now segment standpoint.

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**Maureen B. Short** - *Rent-A-Center, Inc. - Interim CFO*

That's only for internal purposes right now, David. At some point, we may decide to change external disclosures around gross margin and the write-downs, but today, it's just at the store level that they see that transfer price or adjustment to the cost of goods.

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**David Vargas**

Okay. And then the final one for me, can you give us what the total leverage ratio and what the fixed charge coverage ratios were for the quarter?

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**Maureen B. Short** - *Rent-A-Center, Inc. - Interim CFO*

Sure. The leverage ratio was 4.2x, and the fixed charge coverage ratio was 3 -- sorry, it was 1.37x.

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**Operator**

Your next question comes from the line of Brad Thomas.

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**Bradley Bingham Thomas** - *KeyBanc Capital Markets Inc., Research Division - Director and Equity Research Analyst*

Let's see here. I wanted to ask a question on the Core and a question on Acceptance Now, if I could. First with respect to the Core, I was encouraged to hear your commentary, indicating that you believe that you can comp positive in the fourth quarter. I was hoping you could just talk a little bit more about how much that would be a function of sort of the run rate you're seeing in business today and just lapping the easier comparisons versus progress that you still need to be making in the quarters ahead, particularly in an environment where you're -- not only you, but competitors are having a tough time in the Core segments.

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**Mark E. Speese** - *Rent-A-Center, Inc. - Co-Founder, Chairman and CEO*

That's a great question. Clearly, it's not a secret, we're comping over 4 numbers, so one has to conclude that part of this improvement is going to simply be given what we have to comp over. At the same time, I would strongly advocate that it's also going to be from the results that we are seeing already and believe strongly that we'll continue to see as we go forward. Albeit it's only been a quarter's worth of the monthly metrics, I'm excited to share the April one, albeit it won't be for a couple of weeks, but we look forward to showing the April metrics and have no reason to believe that much of what's happening is much of a byproduct of the improvements that we're making in the business.

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**Bradley Bingham Thomas** - *KeyBanc Capital Markets Inc., Research Division - Director and Equity Research Analyst*

Great. And then with respect to Acceptance Now, obviously, the wins to go relationship is an exciting opportunity for you. H.H. Gregg, obviously, not something that you can control, but as you look forward, can you help us understand where you think the door count will end up at the end of the year? And how much of a headwind is it going to be for sales and for profits in that segment to lose 2 customers like H.H. Gregg and Conn's that are pretty big customers for you?

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**Mark E. Speese** - *Rent-A-Center, Inc. - Co-Founder, Chairman and CEO*

Yes. The H.H. Gregg was a disappointment. They were a good partner. And obviously, unfortunate their bankruptcy has taken us out of it. We have a team here that aggressively has been working on new client expansion, so our expectation is to be able to continue to add storefronts through the normal course of business, if you will, like we have. We have the 2 national pilots, both in their early stages, but both fully stood up now, if you will, in terms of the number of stores that were within the pilots. Early into it, but we're excited and pleased with what we're seeing. And obviously, if one of those were to come to fruition it could be very meaningful for the company. In terms of the revenue, clearly, it's a portfolio business, so those will run off. Can we recapture some of those customers through the other partner channels, perhaps, I will tell you from a profitability cash flow standpoint, that's not a negative in the near term. It's a positive. We do, in fact, have the revenue stream and won't have all the cost, and won't have the outlay of cash, either. So that's kind of a mixed bag. But I feel strongly that over time, we'll be able to recapture the lost store count, through new store expansion, new door expansion. And I think, again, I will tell you that we strongly believe that a big opportunity we have as a company is enhancing our unmanned solution, which we are working, I would say, aggressively on.

**Operator**

Your next question comes from the line of John Rowan with Janney.

**John J. Rowan** - *Janney Montgomery Scott LLC, Research Division - Director, Specialty Finance*

Can you explain what aspirational items means? Is it just a higher price point? Or is it a more desirable item?

**Mark E. Speese** - *Rent-A-Center, Inc. - Co-Founder, Chairman and CEO*

It's more a -- well, it's both, I suppose. It certainly comes at a little bit higher price point, but it is -- it's an oversimplification, but rather than a 35-inch TV, it's a 65-inch flat-panel; rather than a vinyl or man-made leather, it's real leather on the sofa; rather than a basic washer; it's a front load. It's the products that consumers see in the paper every Sunday that are being advertised. The high-end fancy washer dryer, the high-end living room products that, by and large, are out of this particular customer's reach, but for only a few dollars more, the ability to get that higher aspirational product revenue than something less expensive. I guess that the way I would explain it is the need and the want. We all -- you need a product and then you want something and aspirational products is going after the emotional side of purchasing, it's the want, not the need. My TV broke, I need one. I can fulfill that at $300, what I want is the $1,000 TV that I might not be able to get otherwise, and how do you bring that to market.

**John J. Rowan** - *Janney Montgomery Scott LLC, Research Division - Director, Specialty Finance*

Okay. Do you think that -- I think, you guys mentioned, I think Maureen talked about early payout options were up year-over-year, did I catch that right? I was actually a little surprised by that, given the late tax refunds, the fact that a lot of money actually fell outside of the 90 days, same as cash purchase window, so can you clarify that?

**Maureen B. Short** - *Rent-A-Center, Inc. - Interim CFO*

Yes, that's correct, John. We did see higher EPOs or early payout options within the Core business. We think it's primarily driven by the promotional activity in the third and fourth quarter, that ended up paying out in the first quarter, because we had a lot of incremental sales of the promotional product that got to the 90 days within the first quarter.

**John J. Rowan** - *Janney Montgomery Scott LLC, Research Division - Director, Specialty Finance*

Okay. And then as far as the debt, was paying down debt, any type of requirement to get covenant relief in the first quarter? And I know you didn't say what the fixed charge covered ratio is going to be, but is it safe to assume that at least 1.37, which is where you stood today, might be -- the new ratio is going to be somewhere below that?

**Maureen B. Short** - *Rent-A-Center, Inc. - Interim CFO*

We paid down -- we had a required payment within the first quarter as an excess cash flow payment. It was around $140 million. And that is why we took out $70 million on the revolver. We do expect to have pressure on the covenant within 2017, which is why we are working on an amendment through our existing credit facility, which we believe will have more covenant flexibility going forward.

**John J. Rowan** - *Janney Montgomery Scott LLC, Research Division - Director, Specialty Finance*

And do you think that you'll be able to pay down debt for the rest -- for at least a couple more quarters, before you hit December? Or is that just kind of dependents on where same-store sales go in the -- any type of change in the on rent number?

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**Maureen B. Short** - *Rent-A-Center, Inc. - Interim CFO*

It definitely depends on the same-store sales. However, we don't believe that we'll be drawing on the revolver in any significant amount throughout 2017.

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**Operator**

Your next question comes from the line of Kyle Joseph with Jefferies.

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**Kyle M. Joseph** - *Jefferies LLC, Research Division - Equity Analyst*

Just looking for a little more color on the Acceptance Now sort of store outlook going forward. Just to clarify, were Conn's and H.H. Gregg -- were those mostly or all manned kiosk locations?

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**Mark E. Speese** - *Rent-A-Center, Inc. - Co-Founder, Chairman and CEO*

They were, yes, they were. They -- in both cases, were -- if not 100%, they were 95% -- yes, 95-plus-percent were manned.

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**Kyle M. Joseph** - *Jefferies LLC, Research Division - Equity Analyst*

Got it. And then, in terms of the closures of the Acceptance Now direct, just looking for a little more color there. I know you mentioned it was a cost-saving initiative. But can you give us a sense for write-offs at Acceptance Now direct versus Acceptance Now staffed? Was it a credit cost-saving metric or credit cost-saving strategy or just expenses across the board?

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**Mark E. Speese** - *Rent-A-Center, Inc. - Co-Founder, Chairman and CEO*

Probably more of the latter. Again, this -- not doing much business in those particular doors. There was a cost of service on them. It's not a big cost, but there wasn't much volume to support it, either, and as Maureen said, what we wanted to do instead was kind of pull it back in and spend the appropriate time and investment developing a platform that will be more user-friendly and can scale much faster and bigger than what that particular application does or did. And so it's not a material, I wouldn't say it was material either in the write-off or cost savings, but it's really more about -- it's not a product that we want to scale. So we're going to bring it down and get it right, and then watch it.

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**Kyle M. Joseph** - *Jefferies LLC, Research Division - Equity Analyst*

Got it. And then shifting to the Core. And given your new strategies, some lingering promotional activity from the second half of last year, just what -- just if you can give us any sort of color on your outlook for the gross margin in the Core, both on a near term and a longer term basis.

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**Mark E. Speese** - *Rent-A-Center, Inc. - Co-Founder, Chairman and CEO*

Well certainly on a longer term, we would expect improvement. You've seen it deteriorate a little bit, given us -- given both the promotional activity and probably more so us being aggressive in trying to push through this inventory. We clearly had too much inventory that showed up in the held for rent numbers. We talked previously about the age of some of that inventory as well as the value. And so we have been aggressive in trying to move that inventory through the system, so that we can more quickly start introducing the new products and mix of the -- appropriate mix of products between the good, better, best, if you will. And -- so this quarter probably will be similar, I suppose, but then as we start to get to the back half, you would certainly expect to see improvements come. And (inaudible), I'm sorry?

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**Kyle M. Joseph** - *Jefferies LLC, Research Division - Equity Analyst*

No, go ahead.

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**Mark E. Speese** - *Rent-A-Center, Inc. - Co-Founder, Chairman and CEO*

I was going to say that again, one of the other directionally -- in the monthly matrix, that'll start to, I think you'll start to get some -- a little bit more visibility into that, when you see the delivery APU. I think that'll start to show the mix of inventory that's now in the system and what's going out, and then how that'll support the comment that I just made. And again, I'm excited to report the -- in a few weeks, the April report card for you.

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**Operator**

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

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**Carla Marie Casella Hodulik** - *JP Morgan Chase & Co, Research Division - MD and Senior Analyst*

Just a couple of follow-up's here. So on the Acceptance Now closure, so we'll see over 200-or-so closures in the second quarter from H.H. Gregg and Conn's. Beyond that, do you think we'll have a net adds in the back half of the year? I'm trying to understand your comment about the 381 closures and whether there's any more in your Acceptance Now existing customers that could close?

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**Mark E. Speese** - *Rent-A-Center, Inc. - Co-Founder, Chairman and CEO*

Well, as we sit here today and based on what we know today from partners and everything else, I don't expect any material loss of stores in the back half of the year. And so if you're asking wherever we may end, at this point, can we grow from here, again, based on what we know, I would say, yes, that we are -- again, we have new pipelines in the works. We have the pilot -- the national pilots in the work -- works, and I'm not aware of any others -- partners that are at risk or that we're dealing differently.

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**Carla Marie Casella Hodulik** - *JP Morgan Chase & Co, Research Division - MD and Senior Analyst*

Okay. Somewhat -- all of those will be in second quarter? Then the H.H. Gregg and the Conn's?

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**Mark E. Speese** - *Rent-A-Center, Inc. - Co-Founder, Chairman and CEO*

Yes.

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**Carla Marie Casella Hodulik** - *JP Morgan Chase & Co, Research Division - MD and Senior Analyst*

And on the Core store side, did you say how many of your stores -- or what's the average lease life? And how many of them come up for renewal this year? And did you give a plan for closures or relocations this year?

**Mark E. Speese** - *Rent-A-Center, Inc. - Co-Founder, Chairman and CEO*

So the average lease term is 5 years, with options to renew, so you can assume on average, 20% of the leases come up annually. That's probably not quite that accurate, but something akin to that. We have not given a specific number in terms of store rationalization. What we said was that we were going to closely monitor store performance throughout the year. And if we are not making the progress or we don't see the opportunities, that we will evaluate them at that particular point in time. So we may see a few things here and there, but at this particular moment, there's not been an announced or planned store rationalization, if you will, in a material way, anyways, at this point.

**Carla Marie Casella Hodulik** - *JP Morgan Chase & Co, Research Division - MD and Senior Analyst*

Okay. And then on the inventory side, it sounds like some of the product that held for rent in Acceptance Now, we should look at that as potential held for rent -- to move over to held for rent at the core over the next quarter, is that the right way to think about it so we could see the core held for rent go up as Acceptance Now comes down?

**Mark E. Speese** - *Rent-A-Center, Inc. - Co-Founder, Chairman and CEO*

Well, yes. First of all, that is the channel -- one of the channels that we use, the primary channel that we used to move the Acceptance Now returns through the system. And so you can expect to see it exit the held for rent under A. Now, and get introduced into the Core business, like it has historically. I think, what'll be different, I wouldn't expect to see the A. Now or the Core health for rent go up because of that. This is how you manage the flow and how you manage the incoming and so forth. So yes, it will move over there, but it's not going to have an adverse impact. It is not my expectation that the core held for rent is going to go back up because of it.

**Carla Marie Casella Hodulik** - *JP Morgan Chase & Co, Research Division - MD and Senior Analyst*

Okay, that's helpful. And just so I understand on the transfer pricing. So when the -- when it's re-marked to wholesale cost from where you purchased it for Acceptance Now, is that product sold from Acceptance Now into the Core at that lower wholesale cost? And will it be a unusual charge on the Acceptance Now business? Or does it flow right through cost of goods sold?

**Mark E. Speese** - *Rent-A-Center, Inc. - Co-Founder, Chairman and CEO*

It's flowing through cost of goods sold, just like it has, historically. What we're doing is right sizing the value in the Core so that they can rent it quicker than they might have otherwise and get the value. We're taking the appropriate cost that gets that unit when it's put out on rent just as if the whole cost had been there. So there's no change in how the cost is being recognized or taken, it's being taken when the unit is pushed through the system. We're just trying to right size the value in the Cores, as they look at the inventory so that they can price it and move it quicker than they might have otherwise.

**Carla Marie Casella Hodulik** - *JP Morgan Chase & Co, Research Division - MD and Senior Analyst*

Okay, great, that makes a lot of sense. And then, when did you start that? Was that just this quarter?

**Mark E. Speese** - *Rent-A-Center, Inc. - Co-Founder, Chairman and CEO*

Late March. Is that right? I'm trying to remember. It was at the end of March, somewhere in that neighborhood. So yes.

**Maureen B. Short** - *Rent-A-Center, Inc. - Interim CFO*

And Carla, again, you won't see anything different as we report this segment this quarter. It's just for internal purposes. So the Core is still being hit with the full cost of the product through the segment financials that we disclose.

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**Operator**

Your next question comes from the line of Laura Champine with Roe Equity Research.

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**Laura Allyson Champine** - *Roe Equity Research, LLC - Senior Analyst for Consumer and Retail*

My question is about mix of product in the stores. Part of your initiatives are to drive a higher mix of higher quality and higher priced products. When will the stores have that full assortment? How long does it take to do that?

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**Mark E. Speese** - *Rent-A-Center, Inc. - Co-Founder, Chairman and CEO*

Well, that will take a little while. The average product is in our system 18 months, and so if you think of it in that sense, in a normal environment, you might turn 60%, 65% of your inventory in a year. So you can kind of back in. If you're wanting to know the entire full mix, you're going out a while. Having said that, it's more about the held for rent and what you're offering to customers to date, not necessarily everything that's on rent. So in that regard, as we think about the held for rent and the product offerings that we're making to the customers, you can expect that to happen much sooner. Again, we're starting to see it. I can tell you that the products that we're ordering today, the replenishment and what we're sending in to the stores is absolutely geared to the proper mix that we want between the good, better, best products. But understand in this case you're bringing in dozens of units into thousands in the system, right? But -- and again, that will show up in this delivery APU that I keep referring to in the monthly matrix, and as I said, we're starting to see that start its march upward.

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**Operator**

We will have a question from the line of Vincent Caintic with Stephens.

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**Vincent Albert Caintic** - *Stephens Inc., Research Division - MD and Senior Specialty Finance Analyst*

My question's actually around the kind of the capital structure that you'd like to have going forward. I know you have -- so you're in your 2018 to 2019 guidance, you have some good revenue growth built into that. And then you've talked about the national accounts that you're working on. But I guess with the current kind of covenant negotiations and maybe some limitations there as well as, I think, Maureen, you had a comment that you wouldn't be increasing the usage of the credit facility, kind of how would you like the capital structure to look like at the end of 2017 to be able to support the growth you've outlined for '18 and '19?

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**Mark E. Speese** - *Rent-A-Center, Inc. - Co-Founder, Chairman and CEO*

Well, I could tell you that the plan that we've articulated, the model that we have supports it. Now we recognize we need to renegotiate the existing facility, which we are in the process of doing. And as Maureen said and as we noted in the press release, we obviously got the waiver for this quarter. We are in discussions, the amendment, if you will, with the current facility. We have good relationships with our lenders and are confident that we can reach that solution. And more importantly, I would tell you, we have sufficient liquidity and flexibility to execute on the plan. So as we sit here today, there's nothing to hinder or to suggest that we can't.

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**Vincent Albert Caintic** - *Stephens Inc., Research Division - MD and Senior Specialty Finance Analyst*

Okay, got it. On the Acceptance Now and on Conn's and H.H. Gregg, would you be able to size the impact on revenue and EBITDA? And kind of give us a sense of the timing of that impact?

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**Mark E. Speese** - *Rent-A-Center, Inc. - Co-Founder, Chairman and CEO*

Well, I think we said before that leases are related to Conn's, they were one of our top 4 from a revenue -- or both of them, I guess, were in the top 7% or top 10%. The annual or average agreement runs about 15 or 18 months under those, so you can -- we haven't given the specifics in terms of their revenue contribution or anything else. We have said that they were 2 of our top 10 players, and so you can kind of estimate that from a revenue standpoint. I can tell you that the average contract or agreement in those, the average remaining life is probably something akin to 15 to 18 months.

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**Vincent Albert Caintic** - *Stephens Inc., Research Division - MD and Senior Specialty Finance Analyst*

Okay, got it, and then just one more on Acceptance Now. I just noticed that the other expenses were lower. And as -- just wondering if there's anything to that if that's going to be maintained at that lower level? Then just any other initiatives that you would like to be doing in second quarter and the rest of 2017?

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**Maureen B. Short** - *Rent-A-Center, Inc. - Interim CFO*

The other store expenses were pretty flat, sequentially. Some of the initiatives that we're focused on within that line item is obviously our losses, and we did see pretty significant sequential improvement relative to last year within losses. And as we continue to tweak and enhance our decision engine, and with the exiting of the Conn's relationship, we do expect our loss rates to continue to improve within the Acceptance Now channel.

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**Mark E. Speese** - *Rent-A-Center, Inc. - Co-Founder, Chairman and CEO*

Yes, then your other question, I think, in terms of other initiatives, I would tell you that, obviously, it's executing the strategic plan that we laid out a few weeks ago, when there are several tenets inside of that, be it in the Core or the Acceptance Now or on the technology and expanding channels. And that is clearly where our focus is. Certainly, the balance of this year.

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**Vincent Albert Caintic** - *Stephens Inc., Research Division - MD and Senior Specialty Finance Analyst*

Okay, got it. Would that mean than that -- so your GAAP earnings was negative in first quarter, but in the future quarters, now that's more of just continue to execute that range between your adjusted and your GAAP with declines, since you won't have many more restructuring? Or should we expect some more of that?

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**Maureen B. Short** - *Rent-A-Center, Inc. - Interim CFO*

We'll have the additional H.H. Gregg stores from the bankruptcy in Q2, and as we sit here today, we don't have any other major restructuring charges expected in 2017.

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**Operator**

We have a follow-up question from the line of Carla Casella with JPMorgan.

**Carla Marie Casella Hodulik** - *JP Morgan Chase & Co, Research Division - MD and Senior Analyst*

I'm wondering if you could give us how much you spent on rental merchandise purchases or give us a sense whether it was up versus the 120 or so you spent last -- or 112 that you spent last year in the first quarter?

**Mark E. Speese** - *Rent-A-Center, Inc. - Co-Founder, Chairman and CEO*

I don't have the number in front of me, Carla. I don't.

**Carla Marie Casella Hodulik** - *JP Morgan Chase & Co, Research Division - MD and Senior Analyst*

Okay. I know it's something we usually have to get from the queue, but just a -- it's a big cash flow item.

**Mark E. Speese** - *Rent-A-Center, Inc. - Co-Founder, Chairman and CEO*

I apologize I don't have it in front of me. It will be in the Q, and that Q will be filed within the next, probably tomorrow or -- yes, the next day or so.

**Carla Marie Casella Hodulik** - *JP Morgan Chase & Co, Research Division - MD and Senior Analyst*

Okay, great. And I know last year's first quarter benefited from a big tax refund. This year, I'm guessing you didn't see a similar unusual move in working capital for taxes, did you?

**Maureen B. Short** - *Rent-A-Center, Inc. - Interim CFO*

No. There were no unusual tax refunds or anything really unusual related to taxes within this first quarter.

**Operator**

There are no further questions at this time. I'd like to hand the call back over to Mr. Mark Speese, Chief Executive Officer and Chairman of the Board of Rent-A-Center.

**Mark E. Speese** - *Rent-A-Center, Inc. - Co-Founder, Chairman and CEO*

Thank you, Zetania. And thank you all for joining us this morning. We sincerely appreciate your time, interest and support. We recognize that we have further work to do to return Rent-A-Center to its industry-leading position. At the same time, we believe we have and are taking the necessary steps to do so, and we're committed to executing the strategic plan in driving value for all of our shareholders. Thank you again for your support and we look forward to sharing our April key metrics in just a few weeks, and we look forward to reporting back again on the second quarter in 90 days. Thanks, have a wonderful day.

**Operator**

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