FINAL TRANSCRIPT

Thomson StreetEvents℠

RCII - Q2 2010 Rent-A-Center Earnings Conference Call

Event Date/Time: Jul. 27. 2010 / 2:45PM GMT

CORPORATE PARTICIPANTS

David Carpenter
Rent-A-Center - VP of IR

Mark Speese
Rent-A-Center - Chairman of the Board & CEO

Mitch Fadel
Rent-A-Center - President & COO

Robert Davis
Rent-A-Center - CFO, Treasurer, SVP of Finance

CONFERENCE CALL PARTICIPANTS

David Burtzlaff
Stephens Inc. - Analyst

Bud Bugatch
Raymond James - Analyst

Laura Champine
Cowen & Company - Analyst

Arvind Bhatia
Stern, Agee & Leach - Analyst

John Rowan
Sidoti & Company - Analyst

John Baugh
Stifel Nicolaus - Analyst

Mike Grondahl
Northland Securities - Analyst

Jordan Hymowitz
Philadelphia Financial - Analyst

PRESENTATION

Operator

Good morning. Thank you for holding. Welcome to Rent-A-Center second quarter 2010 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 on Tuesday, July 27a, 2010. Your speakers today are Mark Speese, Chairman and Chief Executive Officer of Rent-A-Center, Mitchell Fadel, President and Chief Operating Officer, Robert Davis, Chief Financial Officer, and David Carpenter, Vice President of Investor Relations. I would now like to turn the conference over to Mr. Carpenter. Please go ahead, sir.

David Carpenter - *Rent-A-Center - VP of IR*

Thank you, Jackie. 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 remain in the second quarter. If for some reason, you did not receive a copy of the release, you can download it from our website at www.investor.rentacenter.com. Certain financial and statistical information will be discussed during the conference call will also be provided on the same website.

Also, in accordance with SEC rules concerning non-GAAP financial measures, the reconciliation of EBITDA is provided in the 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 and revenues, earnings, operating margins, cash flow and profitability, and other business or trend information are forward-looking statements. These matters are, of course, subject to many factors that could cause actual results to differ materially from our expectations, reflected in the forward-looking statements. These factors are described in the earnings release issued yesterday, as well as our most recent quarterly report on form 10Q, for the quarter ended March 31, 2010. Rent-A-Center undertakes no obligation to publicly update or revise any forward-looking statements.

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

Mark Speese - *Rent-A-Center - Chairman of the Board & CEO*

Thank you, David. Good morning, everyone. And thank you for joining us on our second quarter earnings call.

As you read in the press release, the Company announced strong earnings for the second quarter, ending June 30, as well as the introduction of our first ever cash dividend and an increase in our share-repurchase authorization to $600 million. Now, let me share a little about each of these, and then I'll ask Mitch and Robert to provide some additional details.

With regard to our business in general, despite the slow economic recovery, the overall tone remains fairly positive. What I mean by that, is that our traffic, as measured by the number of deliveries made per week, continues to run at or above last year's numbers, where we saw strong, double-digit increases. The demand for our products and services remains strong. And in fact, we believe that more consumers are coming to appreciate the ease and flexibility of our transaction.

Now, while our rental and fee revenue was slightly less than expected, that was caused by both some price declines, driven by continued deflation in some products, resulting in lower weekly rental payments, and some promotional activity on our part, as well as a slight increase in our weekly delinquency numbers, resulting in lower revenue collected than expected. A slight increase in delinquency did not affect the loss read in the second quarter. But rather, has led to more returns of products and more pickups than would otherwise have been expected. Certainly, consumers remain under pressure, and discretionary spending is limited.

Yet, we continue to see good demand for our products on the front end. Of course, at the same time, we continue to make excellent strides in our expensing agents. Our gross profit margins have improved, being in depreciation or margins on sales products. And our operating expenses have been reduced due to the many control initiatives that have been implemented over the last year that we have spoken of. All of that gives us comfort in raising the low end of our annual guidance, now at $2.65 to $2.80 per share, up from the previous $2.60 to $2.80. So all in all, a good operating quarter for us, and again Mitch and Robert will provide a little more color on that in a moment.

Now let me talk for a moment about our efforts to increase shareholder value. As always our first objective is to invest in the business for the future. In that vein, you have heard us speak of a couple of initiatives that we are working on. One called RAC Acceptance, which is our new model of a kiosk inside retail furniture stores, whereby when a prospective customer is denied credit financing from that retailer, or their credit provider, we, RAC Acceptance, acquire the product from the retailer and offer it to the consumer under a rental-purchase transaction. We now have over 100 of these kiosks inside various retailers, with dozens more in the works.

Of course the other big initiative that we have spoken about is our entry into Mexico. We continue to aggressively prepare for an entry, expecting our first handful of stores to be open during the fourth quarter of this year. That said, and knowing that our third quarter earnings update, which we'll provide in late October, will also include our first outlook for 2011. We will, at that time, be providing a detailed overview of these and other business initiatives, including our strategic rational, our expectations, the timing and the impact. We are very excited about these and we look forward to discussing them in detail with you at that time.

Of course the other exciting news announced in the earnings release, is both the board's authorization of quarterly cash dividend, as well as an increase in our stock repurchase authorization to $600 million, or an additional $100 million. Our strong recurring revenue and cash flow, coupled with our strong balance sheet, provides us with the financial flexibility, and we view these actions as a great way to return value to our shareholders. As mentioned, the first quarterly dividend will be paid on August 26. All common shareholders of record at the close of business on August 12. We expect any future share repurchases will continue to be done opportunistically in the open market, as they have by-and-large in the past. So we remain cautiously optimistic. We know the demand for our products and services is there. We believe our potential market is expanding.

In fact, recent reports on credit scores now show approximately 35% of individuals, up from approximately 27%, with scores -- credit scores, of less than 650, which is considered subprime. Of course while unemployment remains high, the extension of benefits should also prove favorable, allowing consumers to retain or obtain the necessities of life. All the while, we continue to do all that we can to enhance the customer's experience with us.

I do want to thank all of our co-workers for their hard work and their commitment, and I thank you for your support, as well. With that, let me turn it over to Mitch, who will provide you with a few more details on the operational side. Mitch?

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

Thanks Mark, and good morning everyone.

We are pleased to offer results on the quarter as the store and total revenues were within our guidance ranges. Additionally, we see that our earnings guidance was $0.72 per share of earnings, by continuing to execute on our expense management initiatives, and by continuing to improve our inventory margins. Now what is important to understand here, is that even though our revenue per agreement is down slightly, and that causes a slight rental income softness for the quarter, the overall margin per agreement is higher. In other words, there is more deflation on our inventory costs, especially in electronics, than there is in our rental rates and terms. As we have passed some of the deflation passed onto the customer, to remain competitive, we are using some of it to increase inventory margins. A little less revenue per agreement, but more gross dollars per agreement is still a very healthy combination.

The same-store sales were positive 0.1%. Albeit a very small number, it is our first positive comp in seven quarters. Customer traffic and demand remain solid, and the number of units rented on each agreement held steady during the quarter. We are continuing at our target marketing and advertising, focusing on strong value for the consumer.

And we continue to believe, as Mark mentioned, that tightening of consumer credit makes our transactioning even more viable to an increasing number of consumers. Now, with regard to collections, as Mark was talking about, our weekly delinquency average for the quarter was up slightly as the consumer remains under pressure. The good news here is that our customers skips and stolens, as a percent of store revenue for the second quarter came in at 2.2%, tied for the lowest second quarter in the last five years.

Due to the positive impact of the new inventory management system, our health for rent inventory level ended the quarter at 26.5%, slightly above our historical range, but certainly not a level that concerns us. Our new centralized program is getting more merchandise into the stores quicker than when each manager ordered. We certainly have fewer products out of stock now as the program is working. And we will continue to tweak the system. We will soon see what our normal range of health for rent merchandise is with the more proactive ordering system. Some history with this new system will allow us to continue to refine the way it works, both in assortment and inventory productivity.

In financial services we are seeing positive store operating income as that business continues to perform well. Unfortunately, due to legislative changes in three states, we decided to close our 39 kiosks in Washington, Colorado and Arizona. These closures won't have a material impact on our future revenue and earnings. And additionally, we will be opening another 30 kiosks or so between now and year-end in states that currently have favorable legislation, and remain confident in our ability to grow that business in those selected states. In summary, we will continue driving customer traffic to our valued proposition by purchasing high quality products, at good price points and targeting our marketing and advertising accordingly. We will also continue to focus own maintaining control of our delinquencies and losses, while managing our inventory through our new centralized system, all with the overall goal of driving revenue and increasing our margins and profitability.

I would also like to thank our 18,000 co-workers for their excellent execution. And with that, I will turn it over to Robert.

Robert Davis - *Rent-A-Center - CFO, Treasurer, SVP of Finance*

Thank you, Mitch.

I will spend a few moments updating you on our financial highlights during the quarter, as well as our updated guidance for the balance of the year. After which, we will open the call for questions. I would like to mention that much of the information I provide, whether it is historical results or forecasted results, will be presented on a reoccurring and comparable basis. So, at that, minding the press release, total revenues were $671.5 million during the second quarter of 2010, down $8.1 million as compared to the second quarter of last year.

As the press release alluded to, however, taking into account our divestiture of the prepaid telecommunications and (inaudible) subsidiary last Fall, total revenues actually increased during the period, with our same-store sales increasing 0.1%. Margins continue to improve, both on the product side as well as on the operating profit side. We have seen a 50 basis point improvement in our cost of rental fees margins during the quarter, which, along with the continued strength in our expense management initiative, has led to an operating profit margin of 12.3% in the second quarter, an improvement of 150 basis points over the prior year. Net earnings and diluted earnings per share were $47.8 million and $0.72, respectively, increases of 17.2%, and 18% respectively.

Our second quarter EBITDA came in at just over $100 million. A 9.5% increase from the prior year, while it's EBITDA margin increased 140 basis points from the period to 14.9%, our highest quarterly EBITDA margin in the last three years. We continue to post strong results in both EBITDA and margins, and both are improving over historical results. The strong EBITDA results continue to translate into a solid return and capital generation, as we posted positive cash flow during the quarter and ended with over $74 million in cash on hand. During the quarter, we utilized our cash to reduce our outstanding indebtedness by approximately $14 million, between mandatory and optional prepays. The combination of our increase in EBITDA, and lower overall indebtedness, have reduced our leverage to the lowest point in the last six years, to 1.52 times.

Our current leverage, along with the strength in our cash flow, provides us with more than adequate flexibility with regards to capital allocation. As Mark mentioned, we will first and foremost continue to invest in the business. However, our continued effort to return shareholder value, and as a result of our continued belief in long term prospects and value in the Company, during the second quarter we did repurchase over 268,000 shares of our common stock, for approximately $6.5 million. Our goal in enhancing shareholder value is further evident-- our announcement this quarter of our first ever cash dividend, as well as $100 million increase in our Board authorized share repurchase program.

In terms of guidance, we anticipate for the third quarter of 2010, total revenues to range between $648 million to $663 million. And same store sales expect to be approximately flat. At diluted earnings per share, we are guiding the third quarter to a range between $0.52 and $0.58. Our annual guidance for 2010, was for total revenue to fall in the range of $2.706 billion and $2.736 billion, with same store sales expected to be approximately flat. Diluted earnings per share are now expected to range between $2.65 and $2.80, as we have increased the lower end of our previous guidance. In terms of EBITDA and free cash flow, the Company still expects EBITDA to range between $375 million and $395 million, and free cash flow for the year to be in the range of between $120 million and $140 million.

As always, this current guidance excludes any potential benefits associated with potential future stock repurchases or dividends, changes in outstanding indebtedness, or acquisitions or dispositions completed after the date of this press release. With that update, we'd now be happy to take questions.

Jackie if you would now please compile the Q & A roster?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

The first question comes from the line of David Burtzlaff Your line is now open.

David Burtzlaff - *Stephens Inc. - Analyst*

Good morning. And great quarter. A few questions. Mitch, on the inventory, you talked about being at 26.5% idle for the quarter. So, is that something you're still just in the works, and trying to figure out, or is there something that, just with businesses, if it slowed down at all?

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

Well David, I-- maybe a little bit on business slowing down in the summer. That is a seasonal number, anyhow, but I think more so in that it's a more proactive ordering system, and it is filling the needs of the source faster than when 3000 different managers ordered their own inventory. So, I am not sure if it's going to stay around 26.5%. That may be a little high because of the seasonality, and I still think we'll see, even with this system, I think we will see it higher in the summer than in the other quarters. I am not sure exactly where it's going to level up.

We are happy with the way program is working. We are tweaking it a little bit, as with any new system, but I think it is just the fact that it's more proactive than when our managers ordered. 20% to 24% used to be the range we would be in on the inventory health rent, depending on the quarter and the seasonality. And that may move, we are not ready to give a new range yet because we want to see how this new system performs over the next couple of quarters as we tweak it. But in general, it is just because it is a more proactive ordering system than when all 3,000 managers ordered for themselves.

David Burtzlaff - *Stephens Inc. - Analyst*

Okay. And then, Robert, free cash flow in a normal year -- is that around $175 million?

Robert Davis - *Rent-A-Center - CFO, Treasurer, SVP of Finance*

That is closer to a couple hundred million.

David Burtzlaff - *Stephens Inc. - Analyst*

Okay.

Robert Davis - *Rent-A-Center - CFO, Treasurer, SVP of Finance*

I have given you a range of $120 to $140 this year, but we are now going to be paying excess taxes this year as the return of the benefits in prior years, associated with bonus appreciation -- so our cash tax elevation this year is roughly around $170 million, that will normalize in future periods, and we would expect it to be more closely aligned with $200 million.

David Burtzlaff - *Stephens Inc. - Analyst*

Okay. And then, finally, on the payday side of the business, can you quantify-- how that was-- how positive that was this quarter?

Robert Davis - *Rent-A-Center - CFO, Treasurer, SVP of Finance*

Yes, we can. Bear with me just for a second. Mark-- Mitch mentioned store operating income as positive for the year -- for the quarter -- just over $1 million. Now, one thing you may have noticed in our release, the amortization of tangibles was a little bit higher than it had been historically, so the 39 kiosks that we shut down, we did take a charge in the quarter of about $1.5 million on good will, and another about $1.5 million in assets in loan reserves for shutting those stores down.

So, there was a charge in the quarter for financial services business, but not a material number, and overall, it was positive in store operating income level, about $1 million.

David Burtzlaff - *Stephens Inc. - Analyst*

So the million includes about the $3 million charge?

Robert Davis - *Rent-A-Center - CFO, Treasurer, SVP of Finance*

Not the good will piece. About half of it.

David Burtzlaff - *Stephens Inc. - Analyst*

Okay.

Robert Davis - *Rent-A-Center - CFO, Treasurer, SVP of Finance*

So, store operating income, if you break that down, a couple of million, 2.5 million.

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

A couple of million for the quarter without the charge.

David Burtzlaff - *Stephens Inc. - Analyst*

Now is that -- was that above your expectations?

Robert Davis - *Rent-A-Center - CFO, Treasurer, SVP of Finance*

Slightly.

David Burtzlaff - *Stephens Inc. - Analyst*

Okay. So you are seeing pickup and demand -- and the stores that are closed that you said are Washington, Arizona --

---

Robert Davis - *Rent-A-Center - CFO, Treasurer, SVP of Finance*

And Colorado.

David Burtzlaff - *Stephens Inc. - Analyst*

And Colorado. Okay. Thank you very much.

Robert Davis - *Rent-A-Center - CFO, Treasurer, SVP of Finance*

Thanks, David.

Operator

Your next question comes from the line of Bud Bugatch, your line is now open.

Bud Bugatch - *Raymond James - Analyst*

Good morning and congratulations on the quarter. Can you talk a little bit about the dividend policy, how are you are looking at in the future, and how should we think about it in terms of a pay out ratio or other metrics you may -- the board may consider for dividend policy.

Mark Speese - *Rent-A-Center - Chairman of the Board & CEO*

Yes, Bud. This is Mark. At this point, obviously the board authorized the initiation of a dividend for the first time. And as you can calculate it equates to about 1%, $0.06 per share. It is our expectation to continue doing that in the future. Now in terms of how that may move in the future, no decision has been made at this point. Obviously we will continue to evaluate, or reevaluate, if you will, based on other uses of cash or performance in the Company and so forth. As I said, the expectation, of course, is still investing in the business.

And again, in that vein, we will be able to give a lot -- our expectation is to share quite a bit more on this next call, next quarter, in terms of some of these other initiatives, Mexico, RAC Acceptance, and the likes, and we will quantify some of that in terms of cash outlays, and growth ramp up, and return on those investments and so forth. But then, again, that will also all play into any future thoughts or conversations about dividends, in terms of what may change on those in future periods.

Bud Bugatch - *Raymond James - Analyst*

Okay. Talk to us a little bit more about the issue of unemployment amongst your customers, how you are looking at that, maybe, get your crystal ball out and see when you think things may improve, or at what rate they may improve?

Mark Speese - *Rent-A-Center - Chairman of the Board & CEO*

Quite (inaudible) the crystal ball is pretty cloudy when it comes to the unemployment environment. And I say that, it is pretty hard to quantify what percentage of our customers may be on unemployment, and had been receiving benefits, or affected by -- when the benefits stop. Of course, we know that congress passed legislation extending those, so we view that optimistically. It is pretty hard to quantify what impact it's going to have, but I think intuitively we all believe that certainly some segment of our customer base was adversely affected by a lack of employment and/or reduction in benefits and so forth. You know, when it really started a year ago, we started to see more regional impacts of the unemployment. You know, in a couple of states it went up pretty aggressively early on. That -- you don't see much of that anymore. So it's has kind of settled in. Right? I mean, unemployment hasn't really worsened. It hasn't improved, but it hasn't worsened. And so the results that we are seeing today, is pretty consistent throughout the country. They are not regional differences, much like we might have seen a year or year-and-a-half ago. Not to say that some still are not under pressure, but it is, I guess, more consistent, I would say, throughout the country. You know, in terms of -- hopefully things will continue to take place and incentivize businesses to grow. Because that's what is going to then lead to job creation. And it is hard to predict that. Also the benefits being extended. That is a positive. We do view that, at least in the near term, that consumers that might have lost all of their benefits and income, are obviously now going to have some. And as I alluded in my comments, whether that is their ability to retain and/or paying necessities. And I say that whether it is a bed to sleep on, a refrigerator, or whatever the case may be, those are necessities. And so we do view that opportunistically. But consumers are -- and I think we know that -- there is certainly some uncertainty, a lot of uncertainty, in consumer's minds. And they are under a lot of pressure still. Discretionary spending, I think across all businesses, has been not surprising, it's been basically non-existent. I mean, people are spending money, where, when, and how they need to, and not much beyond that, nor should they at this point.

Bud Bugatch - *Raymond James - Analyst*

My last question is, talking about FIN rig. Obviously, it doesn't affect, or at least the near term, the RTO business, but probably payday lending business or the financial services segment. Can you talk a little about what you are seeing so far in that and what your concerns are, and what your views are?

Mark Speese - *Rent-A-Center - Chairman of the Board & CEO*

You are right. As it relate to the rent-to-own, it is not covered, because of the short initial terms. The ASFAB definition of a covered lease and that definition excludes leases with a initial term of 90 days or less, which is what the rent-to-own agreement offers. With regards to the financial service, you are correct in that it is by definition covered. Now what impact that will have on the business in the future is frankly speculative at this point. And I say that, albeit the law has been passed. Of course, they have not yet appointed a commission, or an individual, or a governing body that is going to have the oversight. Once that happens, they, or that person, will then start addressing all the instruments within that and it will be left up to them, in terms of what actions may be put in place in the future. And so, at this point it is purely speculative, because none of that has taken place, and the [card] timing is also part of it. So -- the only thing we can tell you, is yes, financial services, by definition will fall under the CFPA, or CB as they call it now. But what, if any, actual impact that will have on the business, we don't know at this point. Not until it is addressed by that committee.

Bud Bugatch - *Raymond James - Analyst*

Thank you, very much.

Mark Speese - *Rent-A-Center - Chairman of the Board & CEO*

Thanks, Bud.

Operator

Your next question comes from the line of Arvind Bhatia. Your line is now open.

Arvind Bhatia - *Stern, Agee & Leach - Analyst*

Thank you, and good morning.

Mark Speese - *Rent-A-Center - Chairman of the Board & CEO*

Good morning.

Arvind Bhatia - *Stern, Agee & Leach - Analyst*

The first question is just trying to understand the trends throughout the second quarter, how -- if there was any difference from month to month. And then perhaps, post the quarter, what you're seeing so far in July, I heard some of the comments you made, Mark. I just want to understand how things trended over the last few months. And then, I think you said you want to discuss most initiatives next quarter. But I wondered if you could touch on Mexico a little bit, and give us the size of the market that you see, so we can at least start to think in terms of the overall big picture there.

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

I will start with the trend, and then Mark can talk about some of the initiatives. But in the quarter, as Mark pointed out, from a delivery standpoint throughout the quarter, we ended up above the last year. So the demand was there, as we said, the returns were a little higher, and the revenue per agreement was a little low, and that is why we are on the lower end of the revenue guidance. But that revenue per agreement being lower, as I mentioned, Arvind, it is at a higher margin, so that is helping the, I think Robert mentioned, the 50 basis points at the inventory margin level. So, a little less revenue, but a lot less cost in that product is a pretty good combination, in fact, a very good combination. But trends for the business, evens up so far through July has been about what where we expected. The demand is still there. Nothing surprising about July. There was nothing in our guidance going forward, and no surprises. Demand is still there. Certainly, we are seeing the consumer under pressure. But the demand is holding up, as well, not only throughout -- pretty evenly throughout the second quarter, but into July, as well.

THOMSON REUTERS

Mark Speese - *Rent-A-Center - Chairman of the Board & CEO*

Your question concerning Mexico, again, as you alluded, or I alluded, in the next quarter's call it is our expectation to get much more granular on that. And some of the other initiatives, again, what the rational is behind the -- how it fits in with our core competency, how we are going to go about approaching these markets, some of our long term, and short term, expectations in terms of ramp up, use of capital, impact and so forth. Mexico has got 100 million people-plus, so, suffice it to say, all the work that we have done at this point, as we look at the market, the size, the demographics, the consumer, we believe that this model has got application, suffice to say, we still have a lot of learning to do. And until, in fact, we even get them up and running, we have got to prove things out. Which again, we know we will be in a much better position next quarter. We may even have, as I said, we will have the first set open in the fourth quarter, probably have a couple of them opened in advance of that call. And so we will be in a little better position to give more specific information, which is why we chose to say we would do it then, also. So, a lot more to come. But rather than speculating, I would rather be able to give you the specifics of it on the next call, if you don't mind.

Arvind Bhatia - *Stern, Agee & Leach - Analyst*

Sure. Another question for Robert. The salaries and other line, better than expected. Just wondering if you could get into it a little more, and talk about some of the costs -- areas where you have exceeded expectations, and where you think there is more room in the coming quarters?

Robert Davis - *Rent-A-Center - CFO, Treasurer, SVP of Finance*

Sure, Arvind. I think, as you pointed out, the salaries and other lines -- the other areas at the margins, well, the operating costs of margins are improving in large part due to the benefits we are seeing in some of the cost initiatives. So far this year, if you compare it to last year quarter-over-quarter, in that line alone, we have saved or decreased costs approximately $13 million in a couple of quarters. We do expect that number to go up in the third quarter, primarily due to seasonality and the number of business days. But overall for the year, we expect that trend that we have seen to somewhat continue. The area you talked about before are related to areas all across the P&L, from fleet management, to the office and store supplies. We have kicked off a initiative here to really address the sourcing, indirect spend. Mitch talked about more of the product side, and deflation we are seeing in those categories, but we are also taking a more proactive approach on some of the direct spin items that go into supporting the store operations, be it in store operating forms, office supplies, all up and down the P&L. We have already seen some of that benefit, but the longer term impacts, we are still in the middle of that project. We are going to conclude some of that here between now and the end of the year, and we'll be able to give more definitive guidance and color on that. Mark mentioned other initiatives on the October call. One of those is what we're talking about here. Not just store on the growth side, but also some of the things we have been doing on managing costs on the backside. So we will provide more color on that in the October quarter, as well.

Arvind Bhatia - *Stern, Agee & Leach - Analyst*

Thank you, guys, and good luck.

Mark Speese - *Rent-A-Center - Chairman of the Board & CEO*

Thank you, Arvind.

Operator

The next question comes from the line of Laura Champine. Your line is now open.

Laura Champine - *Cowen & Company - Analyst*

Good morning, guys. I have got a follow-up question on the deflation comments that you made. When you said that it is healthy to have price per agreement down because you are driving more -- my interpretation was, you think you are driving more conversions, or more traffic, by having the lower price points. Did I read that right? And if so, how long are you willing to pass on lower prices, or to take a little bit or a margin hit in order to try to drive traffic?

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

Well, it is certainly always a balance, Laura, how we price it against our competition relative to the margin. The -- what I mean by it being healthier, it is not so much that we want to have lower revenue per agreement. We would like to have higher revenue per agreement. But we brought it down a little bit, especially in electronics, since there has been so much deflation in TVs and computers. You have to bring it down some. Of course, you can bring down term or price. We tend to bring down term more than the rate, but to stay competitive, you do have to bring down the rate, as well. But we haven't brought the rate down as much as the cost deflation. That's what's helping the margins.

The revenue per agreement is down just slightly. As you can see we are only off about 1%. If you see about an example this way, Laura, if you just use raw numbers, if you think about a monthly rate of $100, and you know our cost basis is about $25 to every $100. So, if a year ago it was $100 minus $25, today, maybe it is $98 minus $22, so, we have got instead of $75 gross margin, we've got $76 gross margin. And instead of $100 minus $25, we have $98 minus $22. And that is what I mean about that being healthy. Where we are taking some of the cost deflation, passing it on to the customer, and then using some of it to increase our margins. If we can keep it all for margins and leave the revenue per agreement at $100, $100 minus 22, in my example is even better, [plus $78], if you can drive enough business doing that. So we have got to balance it.

Right now we are giving some of the cost deflation into our pricing, and traffic is there. So we think that is driving enough traffic, not enough to offset from a revenue standpoint that little bit of drop, the difference between $100 and $98 from my example. But it's driving enough traffic, we mentioned our deliveries are running ahead of last year, and we are doing it at a higher margin. So we think that is a good combination.

If -- as we can move them back up, we certainly will. The deflation has been so fast in electronics and computers that it is hard to leave the rate up. But we, as you can see in our revenue, we have only dropped it a very slight bit. We are only talking a slight decrease in the revenue, but a nice increase in the margin.

Laura Champine - *Cowen & Company - Analyst*

The other point you mentioned is that delinquency rates have picked up some. And I think you commented that the consumer is under pressure, but the consumer has been under pressure and the delinquency rate have been great. Did something change? Did we hit a wall? Were there any execution issue in the quarter?

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

No, I don't think so. And again, the keyword there I think is "slight" in terms of how much went up. I mentioned the losses. The number we get more specific on every quarter, our loss number is 2.2% for the quarter, tied for the lowest in the last five years. So, the loss number is still running great. It ran great in the second quarter. Again, it is a slight increase. Why now versus -- the fact the customer has been under pressure for quite a while now. I don't have a good answer for you. All I can say is it is a very slight increase.

Laura Champine - *Cowen & Company - Analyst*

Got it. Thank you.

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

Thanks, Laura.

Operator

Your next question comes from the line of John Baugh. Your line is now open.

John Baugh - *Stifel Nicolaus - Analyst*

Thank you. Terrific margin quarter there. I want to go back to the inventory level. Because at 26 and change is certainly above -- and I know it is a seasonally high quarter for you, but I am curious, if you are going to carry a higher inventory help for rent number, my suspicious, or assumption, is that you are seeing some kind of positive revenue impact from that. Is it too early to tell, with the new system? In other words, at trade off, if that happens -- but I assume you need that to happen if you are talking about carrying a higher percentage of inventory on the floor?

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

I certainly agree with that, John. If the new system, by being more proactive, is going to put more inventory in the stores, as it has here in the very early first few months of the system, then we need to do more revenue to pay for that. If we don't, then, if it is not paying off in more revenue, then you have to tweak the system to slow it down a little bit. Right? But if we normalize a couple of percent higher than we used to, then we would expect to see it in the revenue over time. And if not, we will have to tweak this automated system. Because you can't have more inventory without more revenue. You wouldn't want to -- you can't for the first quarter we are on the system, like we are right now. But over time, you wouldn't want to just live with a couple higher percent inventory if you weren't doing anymore revenue.

Mark Speese - *Rent-A-Center - Chairman of the Board & CEO*

The other way I might -- you have heard me say this before, John, because you have followed us a long time. We've always said well, we think ideally you have 100 or 165 pieces of vital inventory at a given time. Well, right now we have about 180. And that is really the difference. I mean, those are real numbers. So, if we have got 15 or 18 more pieces per store. The mixes point -- and then it becomes a question of, the 18 we have, we believe the system is buying products and putting minimums in there that the store didn't otherwise. And so, by default, it is going to go up.

Now as we get experience, we will see which ones we didn't need as much of. And then does that take it back down to the 160? I think what is important, is we don't really know at this point what the real number should be. We said it was always 160, 165, and that was based on how we always did it, which was relying on 3000 buyers. Well today, now with the analytics and predicting side of it, and as we get more history and actual results, that will lead us to where we think that number should be. And again, I don't know where it will settle, 170, 160, 180, but if you've got, again, the right products and the right quantities, then that should also translate into what the goals are in the first place, more deliveries, more revenue.

John Baugh - *Stifel Nicolaus - Analyst*

Okay. And then if we went down the worst case path for payday and you were forced today shut all the stores down, would the charge -- and I calculated about $750,000 per store, that you incurred here, between good will and asset write down, would that be similar for the remaining 300 odd places where you have it, or would it differ? And then, what, if any, cash impact from closing these stores, favorably or negatively?

Robert Davis - *Rent-A-Center - CFO, Treasurer, SVP of Finance*

I'm estimating right now, John, that we have got about $7 million carrying cost on the assets, give or take a few pennies, or a few dollars one way or the other. I don't have that number specific in my mind. But just knowing what the fixed assets costs going into it, and how long they have been open, I am estimating around $7 million fixed asset write off, if we have to go down to your point, the Armageddon route.

Our loan balance right now is around $25 million. One of the highest levels it has ever been. So, from that perspective, it is healthy, and we are growing and it is strong. Then it becomes a matter of what the collectibility on that if the business had to shut down. So, that $25 million wouldn't all be written off until you collect on some of that for quite some time, until you can make a determination that it is uncollectible. So, I would suspect maybe a $10 million number all in, between the assets and maybe reserves on the losses. That is purely the Armageddon route that you referred to.

John Baugh - *Stifel Nicolaus - Analyst*

So, that is the P&L number, 10 million? Robert? How about the cash guess? I guess it depends on how much of those loans you ultimately collect?

Robert Davis - *Rent-A-Center - CFO, Treasurer, SVP of Finance*

It is the $3 million or so that we might determine is uncollectible after we collect out on the loan balance. We have $25 million of working capital on the street, that we are reflecting on as we speak. And as to the extent we are able to collect on that if you shut it down, that would be the cash numbers. The numbers I am giving you, the ten minus the seven on fixed assets is the $3 million or so of cash.

John Baugh - *Stifel Nicolaus - Analyst*

Okay. And then just quickly, I don't believe Canada has favorable regulatory environment for rent-to-own. Is Mexico different? Has something changed there? I'm just curious. I don't want to get into a discussion of Mexico, per say, but just what the laws are down there?

Mark Speese - *Rent-A-Center - Chairman of the Board & CEO*

The current environment is silent on the rental transactions, and we don't deal with them negatively or adversely at this point, based on all the research we have done at this point. Canada, your point, there has been an opinion or ruling or two on it, but that is not the case in Mexico.

John Baugh - *Stifel Nicolaus - Analyst*

Are there other rent-to-own operators operating in Mexico today of any note?

Mark Speese - *Rent-A-Center - Chairman of the Board & CEO*

Not rent-to-own as we define it here, no.

John Baugh - *Stifel Nicolaus - Analyst*

Great. Thank you, good luck.

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

Thanks, John.

Operator

Your next question comes from the line of Mike Grondahl. Your line is now open.

Mike Grondahl - *Northland Securities - Analyst*

Yes, thank you for taking my calls, guys. The first one is on EBIDTA margin. The last two years it really expanded nicely. Where do you think it can go? What other levers do you have to pull there?

Robert Davis - *Rent-A-Center - CFO, Treasurer, SVP of Finance*

Certainly, what we talked about in prepared comments, we have seen healthy increases this year over last, from a seasonality perspective, the third quarter it is expected to be down, sequentially from the second quarter where we are today. But up over the prior year, based on the guidance we have given, overall for 2010, as compared to 2009, we are expecting it to be up in the range of improvement over prior quarters that we have spoken about, 100 basis points or so.

Beyond 2010, we are going to be providing more color on 2011 in a couple of months here, after the third quarter release. That will take into consideration the impact of some of the initiatives ramp up and so forth. So, if you ramp up [and turn up the dial] in Mexico, we would expect some margin decline, for restart-up space, just depending on how material numbers or stores we are looking to ramp up. We haven't made those decisions. I am just trying to let you know that -- what we have seen so far this year is a healthy increase. 2011, we haven't given guidance on yet, but depending on the initiatives and what level you increase those initiatives, we will have an impact on the margins.

Mike Grondahl - *Northland Securities - Analyst*

Sure. And then, if you could just talk to a high level, the dividend announcement I think is very positive, increase in the buy back. What do you guys really want to accomplish here over the next couple years? Is it shrinking your equity base? Is it about capital allocation? Just some thoughts driving returning value to shareholders.

Mark Speese - *Rent-A-Center - Chairman of the Board & CEO*

I would say, Mike, first and foremost, that we believe we can to do that by growing the enterprise. That speaks to the initiatives that we are talking about, albeit Mexico or RAC Acceptance or some of the other things. Beyond that, obviously, we are a mature, healthy company, certainly within the US marketplace, as we've demonstrated time and again. We have got a strong balance sheets. We generate pretty significant free cash flow.

We are comfortable with where the balance sheet is today, based on what we did the last couple of years, as we paid debt down, as we did the amendment extend. That has given us, again, some flexibility to look at other ways of returning value, which is what led the decision of the board to both introduce the dividend, as well as increase the share repurchase. We are not sitting there with a mind-set of how do we just buy back stock, buy back stock. I mean, we will look at that opportunistically. Where it makes sense, we will certainly do that, but there are other ways that we want to return value to the shareholders, which is frankly, growing the enterprise, and then the introduction of the dividend, and maybe even the share repurchase becomes third to

---

Mike Grondahl - *Northland Securities - Analyst*

Great. Just lastly, debt to EBIDTA has fallen in the last three or four years significantly, from maybe 4 to 4.5 times, down to 1.5 times. How do you think about that metric going forward? If this was a private business, what would that number be?

Robert Davis - *Rent-A-Center - CFO, Treasurer, SVP of Finance*

Thinking back historically, our leverage ratios have been high a couple of times primarily as a bi-product of a large acquisition. Back in 1998, we were over 6 times leverage, we were able to grow the EBIDTA levels and maintain a healthy balance of paying down debt. We got that leverage ratio maybe 2 times per show or slightly under. And then in the Fall of 2006 we leveraged back up to make a large acquisition of the number three player in the industry. We were around 4 times leverage at that point.

Again, through growing that enterprise and making increases in EBIDTA, as well as managing the debt balance, we certainly are down below 2 times now at 1.5 as you indicated. We've said all along that we are very comfortable at leverage 2 times or less. We are not afraid to lever back up for the right opportunity and the right reason. But, as we sit here today and think about leverage going forward, just by the sheer nature of mandatory debt payments coming due, and our expectation of growing EBIDTA, the number will continue to decline. To the extent there is a large reason for us to take on initial debt to grow the business, than that obviously will be addressed at that point in time.

Mike Grondahl - *Northland Securities - Analyst*

Got you. Congratulations on a nice quarter and good luck, guys.

Robert Davis - *Rent-A-Center - CFO, Treasurer, SVP of Finance*

Thank you, Mike.

Operator

(Operator Instructions)

Your next question comes from the line of John Rowan. Your line is now open.

John Rowan - *Sidoti & Company - Analyst*

Morning. Mark, you mentioned the kiosk you are installing in other retailers. Can you just remind me, is that only furniture retailers or are you looking to expand that potentially just beyond that group?

Mark Speese - *Rent-A-Center - Chairman of the Board & CEO*

Currently today, it's only furniture retailers. We are considering or exploring how it may be applied beyond furniture, but today it is only furniture.

John Rowan - *Sidoti & Company - Analyst*

Okay, and just one more quick question. Where in Mexico are the stores going to be located?

Mark Speese - *Rent-A-Center - Chairman of the Board & CEO*

Well, initially we are spending most of our time along the border -- I guess what would be considered the east side of the border, from Texas over that way. Ultimately, the expectations would be to go interior as well.

John Rowan - *Sidoti & Company - Analyst*

Do you think there is a opportunity to put financial services in those stores, as well?

Mark Speese - *Rent-A-Center - Chairman of the Board & CEO*

Certainly at some point. We know there are variations or versions of payday lending, if you will, or financial service providers in that country today, both in brick and mortar and internet, and so, might we at some point add that, certainly that is a consideration. It's not our expectation to do it initially.

John Rowan - *Sidoti & Company - Analyst*

Okay. Thank you.

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

Thanks, John.

Operator

Your next question comes from the line of Jordan Hymowitz. Your line is now open.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

Hello guys, thanks for taking my question. Two things -- one, where is the line in the sand now on inventory levels. In other words, the line was always in the low 20s before. Now it's 26 with the new system. Where is the line in the sand, saying it is too much, we have to reduce the inventory?

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

Well, we are not sure yet. It's really the first full quarter that all our stores have been on it, was the past quarter. We are making changes internally on different -- on the way it works, in different product categories. I don't -- I think we need another at least one more quarter, maybe two, to know exactly where -- to draw that line in the sand, as you put it. I think we need another quarter or two to determine that.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

And, can you explain why, again, a new inventory system would make the number go up and not down?

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

Yes. Initially it's because it is more proactive. When we have 3000 managers ordering for themselves, we have more product out of stock. And the reason we put the new system is because we felt like we could reduce those products out of stock, and we have. And that would help the business overall. And in doing that, you would expect a revenue increase down the road. If we have less out of stock, you should expect revenue. If we don't get the revenue increases, if it doesn't help our business, then we'll have to cut back on the inventory. But, the reason is, it is more proactive. It's ordering weekly, not leaving it up to the 3000 managers to do it.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

That makes sense. And, second question, on the payday lending. If you have $25 million on the balance sheet, these companies usually have a 20% loss to revenue numbers, and you said you may only lose $3 million or $4 million. Are you already -- is that 20 something already net of a loss allowance, and you're saying $3 million or $4 million more or is that inclusive of that number.

Robert Davis - *Rent-A-Center - CFO, Treasurer, SVP of Finance*

No. It would be $3 million or $4 million more. There's already a loss allowance on the balance sheet as well.

Robert Davis - *Rent-A-Center - CFO, Treasurer, SVP of Finance*

In this -- continuing a business like this, the losses would run higher than the normal day-to-day business. So, that $3 million would be -- maybe run 30% losses in the wind-down versus 20%.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

And what is the loss allowance of present, again, or what is the gross number of $25 million as a net number.

Robert Davis - *Rent-A-Center - CFO, Treasurer, SVP of Finance*

We're running about a 20% loss rate, so the net number would be roughly $20 million.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

No, the net number would be $25 million and the gross number would be $30 million, right? Is $25 million the net or the gross number?

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

No, $25 million is the gross number. There is a $5 million allowance, roughly, against the $25 million, for a loss provision, if you will.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

Got it, okay. And then you are saying -- that makes sense. Thank you.

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

Thanks, Jordan.

Operator

There are no further questions at this time. I will now turn the call over to Mark Speese. Please go ahead, sir.

Mark Speese - *Rent-A-Center - Chairman of the Board & CEO*

Ladies and gentlemen, thank you very much for your interest. Thank you for joining us today. Do know that we remain focused on growing our business and returning value to our shareholders. And, we do look forward to talking to you next quarter and providing you more insight on these other initiatives, as well as our then quarter results. Thanks again, have a great day, and we look forward to speaking with you in the future.

Operator

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