RENT A CENTER INC DE
Form 10-Q
October 28, 2011

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**
**Washington, D.C. 20549**

**Form 10-Q**

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended September 30, 2011**

**or**

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from __________ to __________**

**Commission File Number: 0-25370**

**Rent-A-Center, Inc.**
*(Exact name of registrant as specified in its charter)*

| | |
|---|---|
| **Delaware** | **45-0491516** |
| *(State or other jurisdiction of incorporation or organization)* | *(I.R.S. Employer Identification No.)* |

**5501 Headquarters Drive**
**Plano, Texas 75024**
*(Address, including zip code of registrant s principal executive offices)*

Registrant s telephone number, including area code: **972-801-1100**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES þ NO o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES þ NO o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

| | | | |
|---|---|---|---|
| Large accelerated filer þ | Accelerated filer o | Non-accelerated filer o (Do not check if a smaller reporting company) | Smaller reporting company o |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES o NO þ

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of October 24, 2011:

| Class | Outstanding |
|---|---|
| Common stock, $.01 par value per share | 58,754,647 |

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The accompanying notes are an integral part of these statements.

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**RENT-A-CENTER, INC. AND SUBSIDIARIES**

**Item 1. Consolidated Financial Statements.**

**CONSOLIDATED STATEMENTS OF EARNINGS**

| | Three months ended September 30, | |
|---|---|---|
| | 2011 | 2010 |
| (In thousands, except per share data) | Unaudited | |
| Revenues | | |
| Store | | |
| Rentals and fees | $ 622,474 | $ 576,019 |
| Merchandise sales | 52,802 | 44,352 |
| Installment sales | 16,348 | 15,599 |
| Other | 4,147 | 20,413 |
| Franchise | | |
| Merchandise sales | 7,250 | 6,975 |
| Royalty income and fees | 1,250 | 1,222 |
| | 704,271 | 664,580 |
| Operating expenses | | |
| Direct store expenses | | |
| Cost of rentals and fees | 142,796 | 127,573 |
| Cost of merchandise sold | 43,170 | 34,807 |
| Cost of installment sales | 5,655 | 5,507 |
| Salaries and other expenses | 405,633 | 389,295 |
| Franchise cost of merchandise sold | 6,926 | 6,680 |
| | 604,180 | 563,862 |
| General and administrative expenses | 33,448 | 30,796 |
| Amortization and write-down of intangibles | 1,261 | 529 |
| Restructuring charge | 7,586 | |
| Total operating expenses | 646,475 | 595,187 |
| Operating profit | 57,796 | 69,393 |
| Interest expense | 8,811 | 6,085 |
| Interest income | (91) | (282) |
| Earnings before income taxes | 49,076 | 63,590 |
| Income tax expense | 17,852 | 23,093 |
| NET EARNINGS | $ 31,224 | $ 40,497 |

| | | | | |
|---|---|---|---|---|
| Basic earnings per common share | $ | 0.52 | $ | 0.62 |
| Diluted earnings per common share | $ | 0.52 | $ | 0.62 |
| Cash dividends per common share | $ | 0.16 | $ | 0.06 |

See accompanying notes to consolidated financial statements.

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## RENT-A-CENTER, INC. AND SUBSIDIARIES
## CONSOLIDATED STATEMENTS OF EARNINGS

| | Nine months ended September 30, | |
|---|---|---|
| | 2011 | 2010 |
| **(In thousands, except per share data)** | **Unaudited** | |
| Revenues | | |
| Store | | |
| Rentals and fees | $ 1,850,698 | $ 1,746,390 |
| Merchandise sales | 203,041 | 176,780 |
| Installment sales | 49,606 | 45,239 |
| Other | 13,629 | 60,272 |
| Franchise | | |
| Merchandise sales | 23,921 | 22,155 |
| Royalty income and fees | 3,807 | 3,706 |
| | 2,144,702 | 2,054,542 |
| Operating expenses | | |
| Direct store expenses | | |
| Cost of rentals and fees | 417,740 | 387,505 |
| Cost of merchandise sold | 151,259 | 129,221 |
| Cost of installment sales | 17,601 | 15,936 |
| Salaries and other expenses | 1,197,922 | 1,161,887 |
| Franchise cost of merchandise sold | 22,875 | 21,202 |
| | 1,807,397 | 1,715,751 |
| General and administrative expenses | 100,048 | 94,744 |
| Amortization and write-down of intangibles | 3,251 | 3,120 |
| Litigation settlement | 2,800 | |
| Impairment charge | 7,320 | |
| Restructuring charge | 12,519 | |
| Total operating expenses | 1,933,335 | 1,813,615 |
| Operating profit | 211,367 | 240,927 |
| Interest expense | 28,184 | 18,219 |
| Interest income | (482) | (606) |
| Earnings before income taxes | 183,665 | 223,314 |
| Income tax expense | 68,323 | 83,526 |

| | | | | |
|---|---|---|---|---|
| NET EARNINGS | $ | 115,342 | $ | 139,788 |
| Basic earnings per common share | $ | 1.86 | $ | 2.13 |
| Diluted earnings per common share | $ | 1.84 | $ | 2.11 |
| Cash dividends per common share | $ | 0.28 | $ | 0.06 |

See accompanying notes to consolidated financial statements.

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**RENT-A-CENTER, INC. AND SUBSIDIARIES**
**CONSOLIDATED BALANCE SHEETS**

| (In thousands, except share and par value data) | September 30, 2011 Unaudited | December 31, 2010 |
|---|---|---|
| **ASSETS** | | |
| Cash and cash equivalents | $ 76,025 | $ 70,727 |
| Receivables, net of allowance for doubtful accounts of $7,976 in 2011 and $8,673 in 2010 | 43,441 | 53,890 |
| Prepaid expenses and other assets | 65,366 | 170,713 |
| Rental merchandise, net | | |
| On rent | 689,975 | 655,248 |
| Held for rent | 187,342 | 181,606 |
| Merchandise held for installment sale | 4,962 | 5,417 |
| Property assets, net | 262,789 | 224,639 |
| Goodwill, net | 1,325,352 | 1,320,467 |
| Other intangible assets, net | 11,265 | 5,624 |
| | $ 2,666,517 | $ 2,688,331 |
| **LIABILITIES** | | |
| Accounts payable trade | $ 96,389 | $ 126,051 |
| Accrued liabilities | 289,618 | 288,415 |
| Deferred income taxes | 272,800 | 218,952 |
| Senior debt | 388,340 | 401,114 |
| Senior notes | 300,000 | 300,000 |
| | 1,347,147 | 1,334,532 |
| COMMITMENTS AND CONTINGENCIES | | |
| **STOCKHOLDERS EQUITY** | | |
| Common stock, $.01 par value; 250,000,000 shares authorized; 107,434,737 and 105,990,704 shares issued in 2011 and 2010, respectively | 1,074 | 1,060 |
| Additional paid-in capital | 747,462 | 712,600 |
| Retained earnings | 1,638,886 | 1,541,168 |
| Treasury stock, 48,697,852 and 42,845,444 shares at cost in 2011 and 2010, respectively | (1,068,443) | (904,274) |
| Cumulative translation adjustment | 391 | 3,245 |
| | 1,319,370 | 1,353,799 |
| | $ 2,666,517 | $ 2,688,331 |

See accompanying notes to consolidated financial statements.

## RENT-A-CENTER, INC. AND SUBSIDIARIES
## CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Nine months ended September 30, | |
|---|---|---|
| | 2011 | 2010 |
| (In thousands) | Unaudited | |
| Cash flows from operating activities | | |
| Net earnings | $ 115,342 | $ 139,788 |
| Adjustments to reconcile net earnings to net cash provided by operating activities | | |
| Depreciation of rental merchandise | 407,775 | 378,335 |
| Bad debt expense | 2,452 | 12,084 |
| Stock-based compensation expense | 3,420 | 3,125 |
| Depreciation of property assets | 47,938 | 47,152 |
| Loss on sale or disposal of property assets | 1,783 | 3,099 |
| Amortization of intangibles | 3,022 | 567 |
| Amortization of financing fees | 1,652 | 1,544 |
| Deferred income taxes | 53,848 | 6,708 |
| Tax benefit related to stock option exercises | (6,536) | (2,342) |
| Impairment charge | 7,320 | |
| Restructuring charge | 12,519 | |
| Changes in operating assets and liabilities, net of effects of acquisitions | | |
| Rental merchandise | (452,490) | (344,636) |
| Receivables | 7,998 | (16,270) |
| Prepaid expenses and other assets | 103,476 | 1,202 |
| Accounts payable trade | (29,662) | (9,318) |
| Accrued liabilities | (13,148) | (28,385) |
| Net cash provided by operating activities | 266,709 | 192,653 |
| Cash flows from investing activities | | |
| Purchase of property assets | (91,979) | (57,373) |
| Proceeds from sale of property assets | 159 | 89 |
| Acquisitions of businesses, net of cash acquired | (4,591) | (3,112) |
| Net cash used in investing activities | (96,411) | (60,396) |
| Cash flows from financing activities | | |
| Purchase of treasury stock | (164,168) | (45,869) |
| Exercise of stock options | 26,006 | 9,703 |
| Tax benefit related to stock option exercises | 6,536 | 2,342 |
| Payments on capital leases | (261) | (800) |
| Proceeds from debt | 658,945 | 55,870 |
| Repayments of debt | (671,719) | (170,944) |
| Dividends paid | (17,485) | (3,949) |
| Net cash used in financing activities | (162,146) | (153,647) |
| Effect of exchange rate changes on cash | (2,854) | 362 |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 5,298 | (21,028) |
| Cash and cash equivalents at beginning of period | 70,727 | 101,803 |

| | | | | |
|---|---|---|---|---|
| Cash and cash equivalents at end of period | $ | 76,025 | $ | 80,775 |

See accompanying notes to consolidated financial statements.

**RENT-A-CENTER, INC. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

1. *Significant Accounting Policies and Nature of Operations.*

The interim financial statements of Rent-A-Center, Inc. included herein have been prepared by us pursuant to the rules and regulations of the Securities and Exchange Commission ( SEC ). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the SEC s rules and regulations, although we believe the disclosures are adequate to make the information presented not misleading. We suggest that these financial statements be read in conjunction with the financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2010. In our opinion, the accompanying unaudited interim financial statements contain all adjustments, consisting only of those of a normal recurring nature, necessary to present fairly our results of operations and cash flows for the periods presented. The results of operations for the periods presented are not necessarily indicative of the results to be expected for the full year.

*Principles of Consolidation and Nature of Operations*. These financial statements include the accounts of Rent-A-Center, Inc. and its direct and indirect subsidiaries. All intercompany accounts and transactions have been eliminated. Unless the context indicates otherwise, references to Rent-A-Center refer only to Rent-A-Center, Inc., the parent, and references to we, us and our refer to the consolidated business operations of Rent-A-Center and all of its direct and indirect subsidiaries.

Our primary operating segment consists of leasing household durable goods to customers on a rent-to-own basis. We also offer merchandise on an installment sales basis in certain of our stores. At September 30, 2011, we operated 3,002 company-owned stores nationwide and in Canada, Puerto Rico and Mexico, including 35 retail installment sales stores under the names Get It Now and Home Choice, and 20 rent-to-own stores in Canada under the name Rent-A-Centre.

We also operate kiosk locations under the trade name RAC Acceptance, which offers the rent-to-own transaction to consumers who do not qualify for financing from the traditional retailer. These kiosks are located within such retailer s store locations. At September 30, 2011, we operated 721 RAC Acceptance locations.

ColorTyme, Inc., an indirect wholly-owned subsidiary of Rent-A-Center, is a nationwide franchisor of rent-to-own stores. At September 30, 2011, ColorTyme had 213 franchised stores operating in 33 states. ColorTyme s primary source of revenue is the sale of rental merchandise to its franchisees, who in turn offer the merchandise to the general public for rent or purchase under a rent-to-own program. The balance of ColorTyme s revenue is generated primarily from royalties based on franchisees monthly gross revenues.

From 2005 to 2010, we also offered an array of financial services in certain of our existing stores under the names RAC Financial Services and Cash AdvantEdge. The financial services we offered included, but were not limited to, short term secured and unsecured loans, debit cards, check cashing and money transfer services.

*New Accounting Pronouncements.* In September 2011, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update 2011-08, *Intangibles Goodwill and Other (Topic 350): Testing Goodwill for Impairment,* ( ASU 2011-08 ), which allows companies to waive comparing the fair value of a reporting unit to its carrying amount in assessing the recoverability of goodwill if, based on qualitative factors, it is not more likely than not that the fair value of a reporting unit is less than its carrying amount. ASU 2011-08 will be effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The adoption of this standard is not expected to have a material impact on our consolidated statement of earnings, financial condition, statement of cash flows or earnings per share.

In June 2011, the FASB issued Accounting Standards Update 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income* ( ASU 2011-05 ), which allows an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders equity. The amendments to the Codification in the ASU do not change the items that must be reported in other

**RENT-A-CENTER, INC. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

comprehensive income or when an item of other comprehensive income must be reclassified to net income and are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of ASU 2011-05 will not have a financial impact on our consolidated statement of earnings, financial condition, statement of cash flows or earnings per share.

In May 2011, the FASB issued Accounting Standards Update 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* ( ASU 2011-04 ). The amendments in this ASU generally represent clarification of Topic 820, but also include instances where a particular principle or requirement for measuring fair value or disclosing information about fair value measurements has changed. This update results in common principles and requirements for measuring fair value and for disclosing information about fair value measurements in accordance with U.S. generally accepted accounting principles ( GAAP ) and International Financial Reporting Standards ( IFRS ). The amendments are effective for interim and annual periods beginning after December 15, 2011 and are to be applied prospectively. Early application is not permitted. The adoption of ASU 2011-04 will not have a material impact on our consolidated statement of earnings, financial condition, statement of cash flows or earnings per share.

From time to time, new accounting pronouncements are issued by the FASB or other standards setting bodies that we adopt as of the specified effective date. Unless otherwise discussed, we believe the impact of any other recently issued standards that are not yet effective are either not applicable to us at this time or will not have a material impact on our consolidated financial statements upon adoption.

2. *Intangible Assets and Acquisitions.*

Amortizable intangible assets consist of the following (in thousands):

| | | September 30, 2011 | | December 31, 2010 | |
|---|---|---|---|---|---|
| | **Avg. Life (years)** | **Gross Carrying Amount** | **Accumulated Amortization** | **Gross Carrying Amount** | **Accumulated Amortization** |
| Non-compete agreements | 3 | $ 6,096 | $ 6,087 | $ 6,094 | $ 6,057 |
| Customer relationships | 2 | 68,928 | 64,784 | 67,811 | 62,224 |
| Vendor relationships | 11 | 7,538 | 426 | | |
| Total | | $ 82,562 | $ 71,297 | $ 73,905 | $ 68,281 |

Estimated remaining amortization expense, assuming current intangible balances and no new acquisitions, for each of the years ending December 31, is as follows (in thousands):

| | **Estimated Amortization Expense** |
|---|---|
| 2011 | $ 1,103 |
| 2012 | 3,528 |
| 2013 | 800 |
| 2014 | 568 |
| 2015 | 568 |
| Thereafter | 4,698 |
| Total | $ 11,265 |

**RENT-A-CENTER, INC. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

A summary of the changes in recorded goodwill follows (in thousands):

| | September 30, 2011 | December 31, 2010 |
|---|---|---|
| Balance as of January 1, | $ 1,320,467 | $ 1,268,684 |
| Additions from acquisitions | 3,170 | 55,922 |
| Goodwill related to stores sold or closed | (229) | (4,320)[1] |
| Post purchase price allocation adjustments | 1,944 | 181 |
| Balance as of the end of the period | $ 1,325,352 | $ 1,320,467 |

(1) Includes $1.8 million of goodwill impairment related to the discontinuation of our financial services business.

Additions to goodwill due to acquisitions in the first nine months of 2011 were tax deductible.

*The Rental Store, Inc.*

On December 20, 2010, we acquired The Rental Store, Inc., a leading provider of consumer lease-purchase transactions through third-party retail furniture and electronics retailers. This acquisition resulted in the addition of 158 kiosks to our RAC Acceptance program as of December 31, 2010. The initial accounting for the acquisition was not finalized as of December 31, 2010 due to the timing of the transaction. In the quarter ending June 30, 2011, we recorded an adjustment of $7.5 million from goodwill to vendor relationships after the analysis of acquired intangible assets was completed. Post purchase price allocation adjustments include the vendor relationship adjustment and various other off-setting adjustments including rental merchandise as discussed in the first quarter 2011.

3. *Senior Credit Facilities.* On July 14, 2011, we announced the completion of the refinancing of our senior secured debt. Our new $750.0 million senior credit facilities consist of a $250.0 million, five-year term loan and a $500.0 million, five-year revolving credit facility. On that day, we drew down $250.0 million in term loans and $100.0 million under the revolving facility and utilized the proceeds to prepay our existing senior term debt.

The full amount of the revolving credit facility may be used for the issuance of letters of credit, of which $136.8 million had been utilized as of September 30, 2011. As of September 30, 2011, $236.2 million was available under our revolving facility. The revolving credit facility and the term loan expire on July 14, 2016.

Borrowings under our senior credit facility accrue interest at varying rates equal to, at our election, either (y) the prime rate plus 0.50% to 1.50%; or (z) the Eurodollar rate plus 1.50% to 2.50%. Interest periods range from seven days (for borrowings under the revolving credit facility only) to one, two, three or six months, at our election. The margins on the Eurodollar rate and on the prime rate, which are initially 1.75% and 0.75%, respectively, may fluctuate dependent upon an increase or decrease in our consolidated leverage ratio as defined by a pricing grid included in the amended credit agreement. We have not entered into any interest rate protection agreements with respect to term loans under our senior credit facilities. A commitment fee equal to 0.3% to 0.55% of the average daily amount of the available revolving commitment is payable quarterly.

Our senior credit facilities are secured by a security interest in substantially all of our tangible and intangible assets, including intellectual property. Our senior credit facilities are also secured by a pledge of the capital stock of our wholly-owned U.S. subsidiaries (other than certain specified subsidiaries).

Our senior credit facilities contain, without limitation, covenants that generally limit our ability to:

- incur additional debt in excess of $250.0 million at any one time outstanding (other than subordinated debt, which is generally permitted if the maturity date is later than July 14, 2017);

- repurchase our capital stock and 6 % notes and pay cash dividends in the event the pro forma senior leverage ratio is greater than 2.50x;

RENT-A-CENTER, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

incur liens or other encumbrances;

merge, consolidate or sell substantially all our property or business;

sell assets, other than inventory, in the ordinary course of business;

make investments or acquisitions unless we meet financial tests and other requirements;

make capital expenditures; or

enter into an unrelated line of business.

Our senior credit facilities require us to comply with several financial covenants. The table below shows the required and actual ratios under our credit facilities calculated as of September 30, 2011:

| | Required Ratio | | Actual Ratio |
|---|---|---|---|
| Maximum consolidated leverage ratio | No greater than | 3.25:1 | 1.66:1 |
| Minimum fixed charge coverage ratio | No less than | 1.35:1 | 1.53:1 |

These financial covenants, as well as the related components of their computation, are defined in the amended and restated credit agreement governing our senior credit facility, which is included as an exhibit to our Current Report on Form 8-K dated as of July 14, 2011. In accordance with the credit agreement, the maximum consolidated leverage ratio was calculated by dividing the consolidated funded debt outstanding at September 30, 2011 ($637.4 million) by consolidated EBITDA for the nine month period ended September 30, 2011 ($383.4 million). For purposes of the covenant calculation, (i) consolidated funded debt is defined as outstanding indebtedness less cash in excess of $25.0 million, and (ii) consolidated EBITDA is generally defined as consolidated net income (a) plus the sum of income taxes, interest expense, depreciation and amortization expense, extraordinary non-cash expenses or losses, and other non-cash charges, and (b) minus the sum of interest income, extraordinary income or gains, other non-cash income, and cash payments with respect to extraordinary non-cash expenses or losses recorded in prior fiscal quarters. Consolidated EBITDA is a non-GAAP financial measure that is presented not as a measure of operating results, but rather as a measure used to determine covenant compliance under our senior credit facilities.

The minimum fixed charge coverage ratio was calculated pursuant to the credit agreement by dividing consolidated EBITDA for the nine month period ended September 30, 2011, as adjusted for certain capital expenditures ($504.8 million), by consolidated fixed charges for the nine month period ended September 30, 2011 ($330.4 million). For purposes of the covenant calculation, consolidated fixed charges is defined as the sum of interest expense, lease expense, cash dividends, and mandatory debt repayments.

Events of default under our senior credit facilities include customary events, such as a cross-acceleration provision in the event that we default on other debt. In addition, an event of default under the senior credit facility would occur if a change of control occurs. This is defined to include the case where a third party becomes the beneficial owner of 35% or more of our voting stock or certain changes in Rent-A-Center s Board of Directors occurs. An event of default would also occur if one or more judgments were entered against us of $50.0 million or more and such judgments were not satisfied or bonded pending appeal within 30 days after entry.

We utilize our revolving credit facility for the issuance of letters of credit, as well as to manage normal fluctuations in operational cash flow caused by the timing of cash receipts. In that regard, we may from time to time draw funds under the revolving credit facility for general corporate purposes. The funds drawn on individual occasions have varied in amounts of up to $25.0 million, with total amounts outstanding ranging up to

$127.0 million. The amounts drawn are generally outstanding for a short period of time and are generally paid down as cash is received from our operating activities.

**RENT-A-CENTER, INC. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

4. *Subsidiary Guarantors.*

*6 % Senior Notes*. On November 2, 2010, we issued $300.0 million in senior unsecured notes due November 2020, bearing interest at 6 %