RENT A CENTER INC DE
Form 10-Q
July 31, 2006

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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 June 30, 2006

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.)*

5700 Tennyson Parkway, Suite 100
Plano, Texas 75024
(972) 801-1100

(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)

NONE

(Former name, former address and former fiscal year, if changed since last report)

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 is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ Accelerated filer o Non-accelerated filer 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 July 26, 2006:

Class	Outstanding
Common stock, $.01 par value per share	69,759,473

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RENT-A-CENTER, INC. AND SUBSIDIARIES

Item 1. Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF EARNINGS

(In thousands, except per share data)	Three months ended June 30, 2006	2005
	Unaudited	
Revenues		
Store		
Rentals and fees	$ 527,076	$ 526,639
Merchandise sales	38,428	37,498
Installment sales	5,728	6,618
Other	3,254	997
Franchise		
Merchandise sales	7,892	7,443
Royalty income and fees	1,245	1,383
	583,623	580,578
Operating expenses		
Direct store expenses		
Cost of rentals and fees	114,733	114,068
Cost of merchandise sold	28,403	28,225
Cost of installment sales	2,398	2,750
Salaries and other expenses	333,113	332,939
Franchise cost of merchandise sold	7,580	7,163
	486,227	485,145
General and administrative expenses	21,253	20,290
Amortization of intangibles	950	2,155
Total operating expenses	508,430	507,590
Operating profit	75,193	72,988
Interest income	(1,399)	(1,351)
Interest expense	13,301	10,786
Earnings before income taxes	63,291	63,553
Income tax expense	23,448	21,811
NET EARNINGS	$ 39,843	$ 41,742

Basic earnings per common share	$	0.57	$	0.56
Diluted earnings per common share	$	0.56	$	0.55

See accompanying notes to consolidated financial statements.

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

(In thousands, except per share data)	Six months ended June 30, 2006	2005
	Unaudited	
Revenues		
Store		
Rentals and fees	$ 1,047,459	$ 1,045,261
Merchandise sales	102,591	100,268
Installment sales	11,579	13,202
Other	6,540	2,075
Franchise		
Merchandise sales	19,973	18,787
Royalty income and fees	2,456	2,794
	1,190,598	1,182,387
Operating expenses		
Direct store expenses		
Cost of rentals and fees	227,500	226,536
Cost of merchandise sold	72,533	70,292
Cost of installment sales	4,821	5,613
Salaries and other expenses	671,884	666,980
Franchise cost of merchandise sold	19,136	18,029
	995,874	987,450
General and administrative expenses	42,211	39,505
Amortization of intangibles	1,836	4,452
Litigation reversion		(8,000)
Total operating expenses	1,039,921	1,023,407
Operating profit	150,677	158,980
Interest income	(2,859)	(2,753)
Interest expense	26,324	21,654
Earnings before income taxes	127,212	140,079
Income tax expense	47,041	50,668
NET EARNINGS	$ 80,171	$ 89,411

Basic earnings per common share	$	1.16	$	1.20
Diluted earnings per common share	$	1.14	$	1.18

See accompanying notes to consolidated financial statements.

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

(In thousands, except share data)	**June 30, 2006 Unaudited**	**December 31, 2005**
ASSETS		
Cash and cash equivalents	$ 41,174	$ 57,627
Accounts receivable, net	20,161	20,403
Prepaid expenses and other assets	34,133	38,524
Rental merchandise, net		
On rent	633,749	588,978
Held for rent	178,667	161,702
Merchandise held for installment sale	1,745	2,200
Property assets, net	154,497	149,904
Goodwill, net	939,130	925,960
Intangible assets, net	3,590	3,366
	$ 2,006,846	$ 1,948,664
LIABILITIES		
Accounts payable trade	$ 72,097	$ 88,147
Accrued liabilities	192,192	191,831
Deferred income taxes	109,652	121,204
Senior debt	417,155	424,050
Subordinated notes payable	300,000	300,000
	1,091,096	1,125,232
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS EQUITY		
Common stock, $.01 par value; 250,000,000 shares authorized; 103,689,987 and 102,988,126 shares issued in 2006 and 2005, respectively	1,037	1,030
Additional paid-in capital	647,234	630,308
Retained earnings	981,569	901,493
Treasury stock, 34,003,899 and 33,801,099 shares at cost in 2006 and 2005, respectively	(714,090)	(709,399)
	915,750	823,432
	$ 2,006,846	$ 1,948,664

See accompanying notes to consolidated financial statements.

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

(In thousands)	Six months ended June 30, 2006	2005
	Unaudited	
Cash flows from operating activities		
Net earnings	$ 80,171	$ 89,411
Adjustments to reconcile net earnings to net cash provided by operating activities		
Depreciation of rental merchandise	222,542	222,839
Depreciation of property assets	26,994	26,534
Amortization of intangibles	1,836	3,733
Amortization of financing fees	798	801
Tax benefit related to stock option exercises	(2,600)	
Deferred income taxes	(11,552)	(30,528)
Changes in operating assets and liabilities, net of effects of acquisitions		
Rental merchandise, net	(276,739)	(233,488)
Accounts receivable, net	242	(238)
Prepaid expenses and other assets	2,699	32,855
Accounts payable trade	(16,050)	(49,442)
Accrued liabilities	6,639	(6,307)
Net cash provided by operating activities	34,980	56,170
Cash flows from investing activities		
Purchase of property assets	(33,321)	(23,932)
Proceeds from sale of property assets	1,734	892
Acquisitions of businesses, net of cash acquired	(21,420)	(26,707)
Net cash used in investing activities	(53,007)	(49,747)
Cash flows from financing activities		
Purchase of treasury stock	(4,691)	(4,012)
Exercise of stock options	10,560	7,633
Tax benefit related to stock option exercises	2,600	
Proceeds from debt	157,125	18,000
Repayments of debt	(164,020)	(61,750)
Net cash provided by (used in) financing activities	1,574	(40,129)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(16,453)	(33,706)
Cash and cash equivalents at beginning of period	57,627	58,825
Cash and cash equivalents at end of period	$ 41,174	$ 25,119

Supplemental cash flow information

Cash paid during the period for:		
Interest	$ 25,404	$ 20,982

Income taxes	$ 50,709	$ 46,408

See accompanying notes to consolidated financial statements.

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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. 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 Commission s rules and regulations, although we believe that 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, 2005, and our Quarterly report on Form 10-Q for the three months ended March 31, 2006. 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 wholly-owned 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.

At June 30, 2006, we operated 2,749 company-owned stores nationwide and in Canada and Puerto Rico, including 21 stores in Wisconsin operated by a subsidiary, Get It Now, LLC, under the name Get It Now, and six stores in Canada operated by a subsidiary, Rent-A-Centre Canada, Ltd., under the name Rent-A-Centre. Rent-A-Center s primary operating segment consists of leasing household durable goods to customers on a rent-to-own basis. Get It Now offers merchandise on an installment sales basis in Wisconsin.

ColorTyme, Inc., an indirect wholly-owned subsidiary of Rent-A-Center, is a nationwide franchisor of rent-to-own stores. At June 30, 2006, ColorTyme had 295 franchised stores operating in 38 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.

New Accounting Pronouncements. On July 13, 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation 48, *Accounting for Uncertainty in Income Taxes: an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 clarifies Statement 109, *Accounting for Income Taxes*, to indicate the criteria that an individual tax position would have to meet for some or all of the benefit of that position to be recognized in an entity s financial statements. FIN 48 is effective for fiscal years beginning after December 15, 2006. We are currently evaluating the requirements under FIN 48 and the effect, if any, that the adoption of FIN 48 will have on our consolidated financial statements, statement of cash flows or earnings per share.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123R, Share-Based Payment (SFAS 123R). SFAS 123R requires employee stock-based compensation awards to be accounted for under the fair value method and eliminates the ability to account for these instruments under the intrinsic value method prescribed by APB Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25). SFAS 123R is effective for fiscal periods beginning after June 15, 2005.

We adopted SFAS 123R on a modified prospective basis beginning January 1, 2006 for stock-based compensation awards granted after that date and for unvested awards outstanding at that date. Under SFAS 123R, compensation costs are recognized net of estimated forfeitures over the award s requisite service period on a straight line basis. For the six months ended June 30, 2006, in accordance with SFAS 123R, we recorded stock-based compensation expense, net of related taxes, of approximately $2.4 million related to stock options and restricted stock units granted, and for the six months ended June 30, 2005 we reported a pro forma expense of approximately $4.4 million under FASB Statement No. 123, *Accounting for Stock-Based Compensation* (SFAS 123). For the three months ended June 30, 2006, in accordance with SFAS 123R, we recorded stock-based compensation expense, net of related taxes, of approximately $1.1 million related to stock options and restricted stock units granted, and for the three months ended June 30, 2005 we reported a pro forma expense of approximately $1.3 million under SFAS 123.

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RENT-A-CENTER, INC. AND SUBSIDIARIES

The Rent-A-Center Amended and Restated Long-Term Incentive Plan (the Prior Plan) terminated on May 19, 2006, upon approval by our stockholders of the Rent-A-Center, Inc. 2006 Long-Term Incentive Plan (the 2006 Plan) as discussed below under the heading Stock Based Compensation. No additional grants will be made under the Prior Plan. Prior to January 2006, we accounted for the Prior Plan under the recognition and measurement principles of APB 25 and related Interpretations. No stock-based employee compensation cost was reflected in net earnings, as all options granted under the Prior Plan had an exercise price equal to the market value of the underlying common stock on the date of grant. If we had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation, net earnings and earnings per share for the six and three months ended June 30, 2005 would have decreased as illustrated by the following table:

	Six months ended June 30, 2005 (In thousands, except per share data)	
Net earnings		
As reported	$	89,411
Deduct: Total stock-based employee compensation under fair value based method for all awards, net of related taxes		4,419
Pro forma	$	84,992
Basic earnings per common share		
As reported	$	1.20
Pro forma	$	1.14
Diluted earnings per common share		
As reported	$	1.18
Pro forma	$	1.12

	Three months ended June 30, 2005 (In thousands, except per share data)	
Net earnings		
As reported	$	41,742
Deduct: Total stock-based employee compensation under fair value based method for all awards, net of related taxes		1,342
Pro forma	$	40,400
Basic earnings per common share		
As reported	$	0.56
Pro forma	$	0.54
Diluted earnings per common share		
As reported	$	0.55

Pro forma	$	0.53

Results for prior periods have not been restated and do not reflect the recognition of stock-based compensation.

Stock Based Compensation. On March 24, 2006, upon the recommendation of the Compensation Committee, the Board of Directors of Rent-A-Center, Inc. adopted, subject to stockholder approval, the 2006 Plan and directed that it be submitted for the approval of the stockholders. On May 19, 2006, the stockholders approved the 2006 Plan. The 2006 Plan authorizes the issuance of 7,000,000 shares of our common stock that may be issued pursuant to awards granted under the 2006 Plan, of which no more than 3,500,000 shares may be issued in the form of restricted stock, deferred stock or similar forms of stock award which have value without regard to future appreciation in value of or dividends declared on the underlying shares of common stock. In applying these limitations, the following shares will be deemed not to have been issued: (1) shares covered by the unexercised portion of an option that terminates, expires, or is canceled or settled in cash, and (2) shares that are forfeited or subject to awards that are forfeited, canceled, terminated or settled in cash. As of June 30, 2006, no shares have been issued under the 2006 Plan.

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RENT-A-CENTER, INC. AND SUBSIDIARIES

Under the Prior Plan, 14,562,865 shares of Rent-A-Center s common stock were reserved for issuance under stock options, stock appreciation rights or restricted stock grants. Options granted to our employees under the Prior Plan generally become exercisable over a period of one to four years from the date of grant and may be exercised up to a maximum of 10 years from the date of grant. Options granted to directors were immediately exercisable. There were no grants of stock appreciation rights and all equity awards were granted with fixed prices. At June 30, 2006, there were 4,448,720 shares allocated to equity awards outstanding. The Prior Plan was terminated on May 19, 2006, upon the approval by our stockholders of the 2006 Plan. No additional grants will be made under the Prior Plan.

The fair value of unvested options that we expect to result in a compensation expense was approximately $13.5 million with a weighted average number of years to vesting of 2.39 years at June 30, 2006 as compared to $18.5 million and a weighted average number of years to vesting of 2.20 years at December 31, 2005.

The total number of unvested options was 1,498,887 and 1,612,472 at June 30, 2006 and December 31, 2005, respectively. The weighted average fair value of unvested options at June 30, 2006 was $8.98 as compared to $11.47 at December 31, 2005. The weighted average fair value on options vested during the three months ended June 30, 2006 was $10.42 and the weighted average fair value of options forfeited during the three months ended June 30, 2006 was $8.24.

The table below summarizes the transactions under the Prior Plan for the period ended June 30, 2006.

	Equity Awards Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life
Balance at December 31, 2004	5,231,538	$ 17.62	
Granted	1,001,000	$ 23.80	
Exercised	(690,608)	$ 13.78	
Forfeited	(522,953)	$ 24.13	
Balance at December 31, 2005	5,018,977	$ 18.70	6.67 years
Granted	523,590	$ 21.43	
Exercised	(701,687)	$ 14.97	
Forfeited	(392,160)	$ 23.78	
Balance outstanding at June 30, 2006	4,448,720	$ 19.16	6.67 years
Exercisable at June 30, 2006	2,949,833	$ 16.76	5.79 years

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RENT-A-CENTER, INC. AND SUBSIDIARIES

During the six months ended June 30, 2006, the weighted average fair values of the options granted under the Prior Plan were calculated using the following assumptions:

Employee options:		
Average risk free interest rate		4.36% - 4.41%
Expected dividend yield		
Expected life		4.20 years
Expected volatility (24.14% to 52.55%)		Weighted average 33.12 %
Employee stock options granted		459,860
Weighted average grant date fair value	$	5.03
Non-employee director options:		
Average risk free interest rate		4.36% - 4.41%
Expected dividend yield		
Expected life		6.00 years
Expected volatility (24.14% to 52.55%)		Weighted average 33.12 %
Non-employee director stock options granted		34,000
Weighted average grant date fair value	$	9.73

For all options granted prior to April 1, 2004, the fair value of these options was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions: expected volatility of 55.2%, risk-free interest rate of 2.9%, expected lives of four years, and no dividend yield. For options granted on or after April 1, 2004, the fair value of the options was estimated at the date of grant using the binomial method pricing model with the following weighted average assumptions: expected volatility of 46.1%, a risk-free interest rate of 3.6%, no dividend yield and an expected life of four years. For options granted in 2005, the fair value of the options was estimated at the date of grant using the binomial method pricing model with the following weighted average assumptions: expected volatility of 42.1%, a risk-free interest rate of 3.9%, no dividend yield and an expected life of four years.

Tax benefits from stock option exercises of $2.6 million for the six months ended June 30, 2006 were reflected as an outflow from operating activities and an inflow from financing activities in the Consolidated Statement of Cash Flows. For the six months ended June 30, 2005, the tax benefits from stock option exercises of $2.1 million were included as a cash inflow to cash provided by operating activities.

Change in Accounting Estimate. During the second quarter of 2006, we refined the process in which we determine the net amount accrued for losses within our self-insured retentions based on our actual loss experience. At June 30, 2006, our consolidated statements of earnings reflect a benefit of approximately $2.0 million from the normal accrual level resulting from the use of certain company specific loss development factors developed by independent actuaries, rather than the general industry loss development factors we previously used.

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RENT-A-CENTER, INC. AND SUBSIDIARIES

Reconciliation of Merchandise Inventory.

	Six months ended June 30, 2006	Six months ended June 30, 2005
	(In thousands)	
Beginning merchandise value	$ 752,880	$ 760,422
Inventory additions through acquisitions	7,084	2,832
Purchases	392,986	344,985
Depreciation of rental merchandise	(222,542)	(222,839)
Cost of goods sold	(77,354)	(75,905)
Skips and stolens	(26,169)	(28,583)
Other inventory deletions [1]	(12,724)	(7,009)