



Date: November 10, 2020
Company Ticker: AAN
Sector: Consumer Discretionary
Industry: Household Durables

Forward P/E: 11.19
Sector Forward P/E: 9.70
Market Price: \$60.60
Estimated Fair Price: \$29.77

Recommendation: Sell

Company Summary

Aaron's is a lease-to-own service provider of furniture, consumer electronics, computers, home appliances, and accessories. They operate in three core business segments: Aaron's business, Progressive Leasing, and Vive. Aaron's business refers to their brick and mortar stores and e-commerce. Progressive Leasing is a virtual lease-to-own company that provides lease-purchase solutions. Vive offers customized programs along with services including revolving loans through private label cards.

Industry Outlook

Aaron's operates primarily in-home furniture rental, consumer electronics, and household appliance rental. The home furniture rental industry is in decline, while the consumer electronics and appliances rental industry is growing. This can be attributed to a favorable shift in buyer preference towards lease-to-own transactions, the gradual reopening of franchise stores nationwide, and technological advancements in the portfolio of products Aaron's carries. One thing to observe for Aaron's and similar companies is the creditworthiness of consumers. If an increasing number of consumers have subprime credit, businesses like Aaron's will likely see increased sales. However, the previous yearly and projected declines in non-retail sales significantly hurt Aaron's growth potential. We believe the market in which Aaron's e-commerce platform operates is saturated, with larger players possessing greater economies of scale, access to distribution networks, and marketing.

Earnings Forecast

The earnings forecast for Aaron's is based on various drivers, such as current assets as a percentage of sales, debt trends, etc. (see our earnings forecast to view and interact with all drivers and assumptions). Again, while some of these drivers are standard, some are firm/industry specific. An example of a firm specific driver for Aaron's depreciation of lease merchandise as a percent of Revenue QoQ (quarter over

quarter). Almost all line entries are based on the drivers mentioned above, which are based on historical averages and regression analysis.

Account Information Report Date	Forecast					As Reported Historical Data		
	Dec-24	Dec-23	Dec-22	Dec-21	Dec-20	Dec-19	Dec-18	Dec-17
Income Statement								
Lease revenues & fees	5,546,927	5,114,264	4,715,349	4,347,550	4,008,439	3,698,491	3,506,418	3,000,231
Retail sales	53,721	51,194	48,786	46,491	44,304	38,474	31,271	27,465
Non-retail sales	42,448	54,535	70,063	90,012	115,641	140,950	207,262	270,253
Franchise royalties & fees	(44,769)	(24,181)	(6,480)	8,751	21,857	33,432	44,815	48,278
Interest & fees on loans receivable	52,637	48,691	45,092	41,826	38,881	35,046	37,318	34,925
Other revenues	1,600	1,600	1,600	1,600	1,600	1,263	1,839	2,556
Total revenues	5,547,290	5,148,721	4,784,226	4,452,577	4,152,959	3,877,564	3,754,287	3,313,858
Depreciation of lease merchandise	2,870,200	2,655,000	2,458,700	2,280,600	2,120,100	1,972,358	1,727,904	1,448,631
Retail cost of sales	34,000	32,400	30,900	29,400	28,000	24,024	19,819	17,578
Non-retail cost of sales	36,400	46,800	60,100	77,200	99,200	113,229	174,180	241,356
Operating expenses	2,219,000	2,053,000	1,901,000	1,763,000	1,639,000	1,524,849	1,618,423	1,403,985
Restructuring expenses, net	24,319	36,872	20,224	2,659	73	39,990	1,105	17,994
Legal & regulatory expense (income)	-	-	-	-	-	179,261	-	-
Impairment of Investment	-	-	-	-	-	-	40,196	-
Other operating expense (income), net	1,094	8,750	1,254	1,805	10,008	11,929	2,116	535
Total costs & expenses	5,185,012	4,832,822	4,472,178	4,154,664	3,896,381	3,865,640	3,583,743	3,130,079
Operating profit (loss)	362,278	315,899	312,048	297,913	256,577	11,924	170,544	183,779
Interest income	1,560	1,560	1,560	1,560	1,560	1,790	454	1,835
Interest expense	21,140	19,570	18,130	16,840	16,220	16,967	16,440	20,538
Impairment of investment	-	-	-	-	-	-	40,196	-
Other non-operating income (expense), net	2,400	2,400	2,400	2,400	2,400	2,091	1,320	3,581
Earnings (loss) before income taxes	345,098	300,289	297,878	285,033	244,317	(1,162)	115,682	168,657
Income tax expense (benefit)	147,143	128,037	127,009	121,532	104,172	61,316	55,994	52,959
Net earnings (loss)	197,956	172,252	170,869	163,501	140,146	(62,478)	171,676	115,698

Valuation

A standard long term FCFE growth rate of 3.50% is used, while the short-term growth rate comes from historical trends (averages) year over year. The short-term growth rate we calculated was 8.46%. The Cost of equity is dependent on the long-term growth rate and the firm forward P/E ratio. The cost of equity we calculated was 12.81%. The sector forward P/E ratio was pulled from Yardini Research on November 11th, 2020.

Free Cash Flow to Equity (FCFE)	Dec-24	Dec-23	Dec-22	Dec-21	Dec-20	Dec-19	Dec-18	Dec-17	Dec-16
Net Income	206,503	177,935	170,963	162,778	130,079	(62,478)	171,676	115,698	85,357
Add back depreciation	181,781	162,902	145,984	130,823	117,236	105,061	94,150	82,572	82,378
Subtract increase in current assets	(177,829)	(162,149)	(147,165)	(132,675)	(81,373)	(162,524)	(98,504)	99,486	(133,702)
Add back increase in current liabilities	29,766	27,141	24,633	22,208	20,435	(20,337)	(11,657)	7,044	(2,590)
Subtract increase in fixed assets at cost	(38,427)	(38,322)	(38,322)	(38,322)	(35,828)	(35,139)	(63,469)	(7,977)	6,255
Net new Debt	-	-	(2,522)	(37,548)	(72,573)	(84,531)	55,917	(135,035)	(109,679)
Free cash flow	201,793	167,508	153,570	107,264	77,976	(259,948)	148,113	161,788	(71,981)

Discounted Cash Flows

Cost of Equity	13.81%
Long Term Growth in Free Cash Flow	3.50%
Short Term Growth Rate	8.46%
Sector Forward P/E Ratio	9.7

Report Date	Dec-24	Dec-23	Dec-22	Dec-21	Dec-20	Dec-19	Dec-18	Dec-17	Dec-16
Free cash flow	186,211	158,557	150,011	77,845	74,703	(259,948)	148,113	161,788	(71,981)
Terminal Value	1,869,465								
Total	2,055,675	158,557	150,011	77,845	74,703				

Enterprise value	2,115,948	<i>Item will vary within spreadsheet due to probability range</i>
Add Year 0 cash and marketable securities	57,755	
Asset value in year 0	2,173,703	
Subtract out value of firm's debt today	(285,801)	

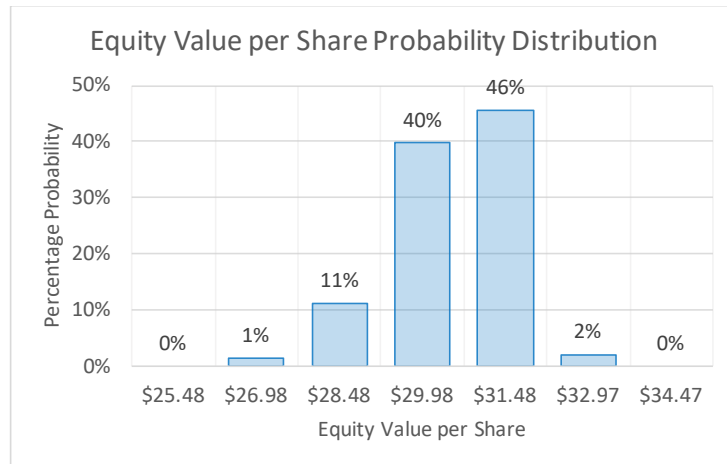
Most Likely Equity Value	1,985,920	
Year end shares outstanding	66,718	
Most Likely Equity Value Per Share	\$ 29.77	
11/17/2020 Trading	\$ 60.60	<i>Overvalued by 50.9%</i>

Current Outstanding Recommendation **SELL**

Sensitivity Analysis

While we have an idea of what the most likely equity value, and subsequently, the equity value per share is, we have also sketched out other equity values, and the probabilities of these values. The equity value per share that we believe to be most likely is \$29.77.

Equity Value	Equity Value per Share	Probability
\$ 1,700,000	\$ 25.48	0%
\$ 1,800,000	\$ 26.98	1%
\$ 1,900,000	\$ 28.48	11%
\$ 2,000,000	\$ 29.98	40%
\$ 2,100,000	\$ 31.48	46%
\$ 2,200,000	\$ 32.97	2%
\$ 2,300,000	\$ 34.47	0%



Conclusion

Based on the above analysis and calculations, we are recommending that the fund sell its positions in Aaron's. We believe that the shares are currently overvalued by around 50%, with an equity value per share of \$29.77, compared to the price of \$60.60.