

Aarons, Inc. (AAN)

\$60.24 (As of 01/16/20)

Price Target (6-12 Months): **\$63.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 11/12/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:A

Value: A

Growth: A

Momentum: F

Summary

Shares of Aaron's have declined and underperformed the industry in the past three months. The company reported lower-than-expected results in third-quarter 2019. Moreover, its EBITDA margin fell year over year. Lower active door count also hurt the results. Management narrowed its outlook for 2019. It now envisions adjusted earnings of \$3.75-\$3.85 per share, down from \$3.85-\$4.00 stated earlier. However, its top and bottom lines improved year over year in the third quarter. Strength in the Progressive segment on robust invoice volume and solid customer base is aiding top-line growth. Contributions from franchised stores acquired by the Aaron's Business segment throughout 2018 is also acting as a catalyst. In addition, its transformational initiatives to bring Aaron's Business back to sustainable growth are impressive.

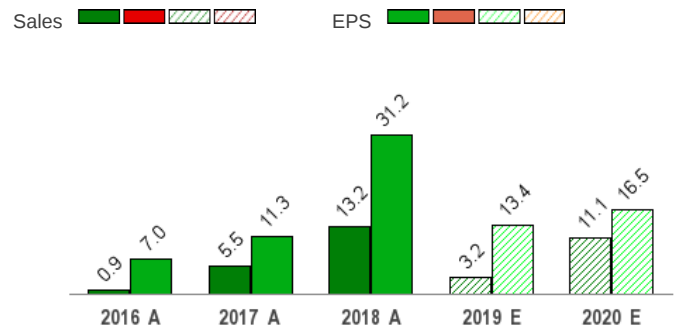
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$78.59 - \$47.00
20 Day Average Volume (sh)	498,957
Market Cap	\$4.0 B
YTD Price Change	5.5%
Beta	0.37
Dividend / Div Yld	\$0.16 / 0.3%
Industry	Retail - Consumer Electronics
Zacks Industry Rank	Bottom 3% (246 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-11.0%
Last Sales Surprise	-1.7%
EPS F1 Est- 4 week change	-0.5%
Expected Report Date	02/13/2020
Earnings ESP	2.7%
P/E TTM	16.0
P/E F1	13.6
PEG F1	0.8
P/S TTM	1.0

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	1,088 E	1,072 E	1,081 E	1,129 E	4,389 E
2019	1,012 A	968 A	964 A	1,007 E	3,951 E
2018	955 A	928 A	953 A	993 A	3,829 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$1.14 E	\$1.06 E	\$0.94 E	\$1.29 E	\$4.44 E
2019	\$1.08 A	\$0.93 A	\$0.73 A	\$1.07 E	\$3.81 E
2018	\$0.81 A	\$0.84 A	\$0.69 A	\$1.02 A	\$3.36 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/16/2020. The reports text is as of 01/17/2020.

Overview

Based in Atlanta, GA, Aaron's, Inc. is a major omni-channel provider of lease-purchase solutions, mainly to underserved and credit-challenged customers. Through its various business segments, the company primarily deals in sales and lease ownership, apart from specialty retailing in furniture, home appliances, consumer electronics, as well as accessories.

Additionally, Aaron's stores offers products from popular brands like Philips, Samsung, Whirlpool, Hewlett-Packard, LG, Simmons, and Ashley, among others.

Furthermore, the company has three operating and reportable segments: Progressive Leasing, Aaron's Business, and DAMI.

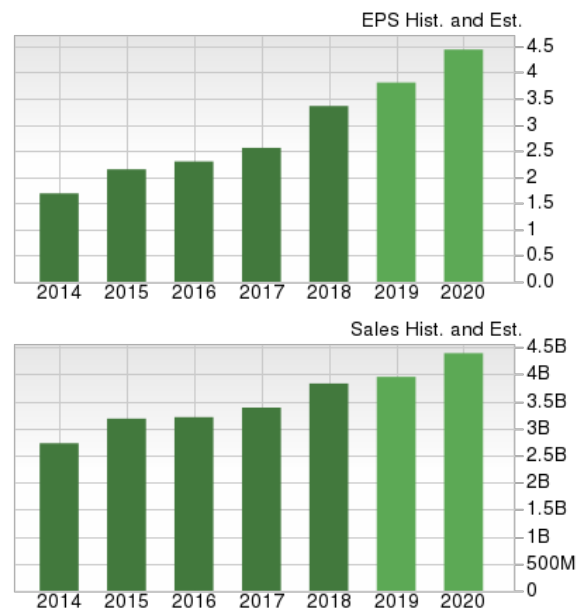
- **Progressive Leasing (54.9% of total Revenues in 3Q19):** This segment includes the virtual lease-to-own business. It partners with various retailers, mainly in the furniture and bedding; electronics and accessories; mobile; jewelry; consumer electronics; automobile; as well as appliance industries to provide a lease-purchase option for credit-challenged customers. Progressive Leasing had retail partners across 46 states and the District of Columbia.

As of Sep 30, 2019, this division had 953,000 customers, reflecting 17.9% growth year over year.

- **Aaron's Business (44.2%):** This segment centers on around Aaron's branded company-owned and franchised lease-to-own stores, Aarons.com and Woodhaven, the company's furniture manufacturing facilities. Additionally, this operating unit supports franchisees of its Aaron's stores.

As of Sep 30, 2019, the Aaron's Business segment had 1,163 company-operated stores and 341 franchised stores.

- **Dent-A-Med, Inc. – DAMI (0.9%):** Acquired in 2015, the DAMI segment mainly serves customers that are not eligible for traditional prime lending. It operates as a wholly-owned subsidiary of Progressive Leasing and provides customized programs including revolving loans, private label cards and access to the processing platform.



Reasons To Buy:

▲ **Robust Progressive Business Performance:** Aaron's has been experiencing continued strength in its Progressive segment, which covers the virtual lease-to-own business. The segment has been performing exceedingly well for quite some time now, backed by robust growth in invoice volume and a solid customer base. Notably, the segment's revenues have doubled from \$1 billion in 2015 to \$2 billion in 2018, while consistently generating strong profits. In third-quarter 2019, the segment's revenues increased 4.9% year over year. Invoice volume grew 18.6%, owing to 20.5% rise in invoice volume per active door. As of Sep 30, 2019, the division had 953,000 customers, reflecting 17.9% growth year over year. Further, the segment's EBITDA grew 21.5% in the reported quarter, with margin expansion of 20 basis points (bps). For 2019, the company expects revenues of \$2,100-\$2,150 million and adjusted EBITDA of \$275-\$280 million for the segment.

Aaron's Progressive segment continues delivering robust growth driven by higher invoice volume coupled with a solid customer base. In third-quarter 2019, the segment's revenues grew 4.9%.

▲ **Aaron's Business Transformation on Track:** The Aaron's business is progressing well with its transformational initiatives over the past few years. These initiatives are likely to bring the segment back to sustainable long-term growth in revenue and earnings, through investments in activities to improve customer experience, operating efficiencies, compliance and employee engagement. Driven by the success of the pilots carried out in 2018, the company is on track to expand the next generation concept to 40 to 50 locations in 2019, including renovating existing stores and repositioning to new more attractive store locations. These new store concepts are poised to lift in store level traffic and revenue. Additionally, the company's e-commerce site (Aarons.com) has witnessed significant growth in the past few years and is attracting new and younger customers.

▲ **Solid Cash Position & Shareholder-Friendly Moves:** Aaron's boasts a healthy balance sheet, which enables it to invest in the business and reward shareholders. As of Sep 30, 2019, the company had cash and cash equivalents of \$150.3 million, compared with \$15.3 million as of Dec 31, 2018. As of Sep 30, 2019, it generated cash from operations of \$350.8 million. Moreover, the company ended third-quarter 2019 with available liquidity of \$537 million and net debt to adjusted EBITDA ratio of below 0.5 turns. During the quarter, Aaron's returned nearly \$27 million through share buybacks and dividends. Recently, management hiked its quarterly cash dividend by 14.3% to \$0.04 per share, from the prior payout of \$0.035. This increased dividend is payable Jan 6, 2020, to shareholders of record as on Dec 19, 2019.

Reasons To Sell:

▼ **Stock Underperforms, Valuation Looks Stretched:** Shares of Aaron's have lost 16.7% in the past three months against the industry's 21% rally. A decline in share price can mostly be attributed to soft third-quarter 2019 results and revised view for the year. Considering price-to-earnings (P/E) ratio, Aaron's looks pretty overvalued when compared with the industry. The stock has a trailing 12-month P/E ratio of 16.02x, which is below the median level of 15.86x and the high level of 20.78x scaled in the past year. However, the trailing 12-month P/E ratio for the industry is 14.86x. Given these factors, we believe that the stock is quite stretched from the P/E aspect.

Aaron's posted lower-than-expected earnings and revenues in third-quarter 2019. Moreover, management narrowed the earnings outlook for the current year.

▼ **Soft Q3 Results & Outlook:** Aaron's posted lower-than-expected results in third-quarter 2019, wherein the top and bottom lines lagged the Zacks Consensus Estimate. Despite the gains from the Progressive business, the top line lag can be attributed to decline in revenues at the Aaron's segment owing to store closures that occurred in the first half of 2019. Further, the company's adjusted EBITDA margin was down 30 basis points (bps) to about 9% when calculated on a basis with respect to the 2019 adoption of ASC 842 associated with lease accounting. Furthermore, management narrowed its view for 2019. It now projects total revenues of \$3,905-\$4,010 million compared with \$3,905-\$4,065 million mentioned earlier. Adjusted EBITDA is now anticipated to be \$425-\$437 million, down from \$430-\$452 million stated previously. For 2019, management now expects adjusted earnings of \$3.75-\$3.85 per share, down from \$3.85-\$4.00 stated earlier.

Total revenues at the Aaron's Business segment are now projected to be \$1,775-\$1,825 million versus \$1,775-\$1,855 million mentioned earlier. Revenues at the Progressive segment are envisioned to be \$2,100-\$2,150 million compared with \$2,100-\$2,175 million mentioned earlier. The Aaron's Business segment's adjusted EBITDA is now anticipated to be \$155-\$160 million versus \$160-\$170 million mentioned earlier. EBITDA at the Progressive division is now envisioned to be \$275-\$280 million compared with \$275-\$285 million mentioned earlier. For the DAMI segment, management continues to project adjusted EBITDA of negative \$3-\$5 million.

▼ **Soft Active Door Counts:** Despite growth in revenues due to higher invoice volume, the company's active doors were down 1.6% to approximately 19,900 during third-quarter 2019. This resulted from a decline in active doors inside mattress and mobile compared with the year-ago period. However, the company believes door count is becoming less predictive as a leading indicator of future revenue growth.

Last Earnings Report

Aaron's Misses Q3 Earnings Estimates, Revises View

Aaron's posted lower-than-expected results in third-quarter 2019, wherein the top and bottom lines lagged the Zacks Consensus Estimate.

While earnings missed after two straight quarters of reporting a beat, sales lagged after in-line results in the previous quarter.

Further, management revised guidance for 2019.

Quarter Ending **09/2019**

Report Date	Nov 04, 2019
Sales Surprise	-1.68%
EPS Surprise	-10.98%
Quarterly EPS	0.73
Annual EPS (TTM)	3.76

Q3 Highlights

Aaron's delivered adjusted earnings of 73 cents per share, which lagged the Zacks Consensus Estimate of 82 cents. However, the metric rose 5.8% from the prior-year quarter.

Including one-time items, the company reported GAAP earnings per share of 58 cents, down 6.5% from the year-ago quarter.

Consolidated revenues were \$963.8 million, which inched up 1.1% year over year but missed the Zacks Consensus Estimate of \$980 million.

The top line grew 8.4% when calculated on a basis with respect to the 2019 adoption of ASC 842 associated with lease accounting.

Revenue growth was backed by an increase in Progressive revenues and contributions from franchised stores acquired by the Aaron's Business segment. This was partly offset by the company's store closures in the first half of 2019.

Further, Aaron's franchisee revenues declined 19.8% to \$103.5 million. However, same-store revenues for franchised stores grew 1.7%, while same-store customer counts decreased 3.7% in the reported quarter. Notably, the company's franchisees had a customer base of 241,000 at the end of the quarter.

Adjusted EBITDA rose 5.6% year over year to \$87.1 million, thanks to robust growth at the Progressive segment.

However, the adjusted EBITDA margin was down 30 basis points (bps) to about 9% when calculated on a basis with respect to the 2019 adoption of ASC 842.

Segment Details

Progressive Leasing

Revenues at the segment grew to \$528.9 million in the reported quarter, up 4.9% year over year. Invoice volume rose 18.6%, owing to 20.5% rise in invoice volume per active door, partly offset by 1.6% reduction in active doors to roughly 19,900. As of Sep 30, 2019, this division had 953,000 customers, reflecting 17.9% growth year over year.

The segment's EBITDA was \$62.9 million, up 21.5% from the year-ago quarter. Further, EBITDA margin expanded 20 bps to 11.9%.

Aaron's Business

Total revenues at the Aaron's Business segment fell 2.9% to \$426.3 million, thanks to the lack of revenues from net decrease of 149 stores in 2019, partly offset by gains from contributions from the buyout of 152 franchised locations. Moreover, both same-store revenues and customer count declined 2.9%.

Non-retail sales tumbled 29.9% on a year-over-year basis. Lease revenues and fees for the three months ended Sep 30, 2019, grew 0.4% from the year-ago quarter. At the quarter end, company-operated Aaron's stores had 963,000 customers, reflecting a 2.6% year-over-year decrease.

The segment's adjusted EBITDA was \$25.7 million, down 21.4% year over year due to lower collections. Also, adjusted EBITDA margin contracted 140 bps to 6%.

As of Sep 30, 2019, the Aaron's Business segment had 1,163 company-operated stores and 341 franchised stores.

DAMI

Sales at the DAMI segment amounted to \$8.7 million compared with \$9.5 million in the year-ago period.

Financial Position

Aaron's ended the quarter with cash and cash equivalents of \$150.3 million, debt of \$347.1 million, and shareholders' equity of \$1,867.7 million. As of Sep 30, 2019, the company generated cash from operations of \$350.8 million.

Moreover, it repurchased 399,424 shares for \$25 million in the third quarter. The company expects capital expenditure of \$90-\$100 million for 2019.

Guidance

Management now projects total revenues of \$3,905-\$4,010 million for 2019 compared with \$3,905-\$4,065 million mentioned earlier. Adjusted EBITDA is now anticipated to be \$425-\$437 million compared with \$430-\$452 million stated previously.

Total Revenues at the Aaron's Business segment are now projected to be \$1,775-\$1,825 million versus \$1,775-\$1,855 million mentioned earlier. Revenues at the Progressive segment are envisioned to be \$2,100-\$2,150 million compared with \$2,100-\$2,175 million mentioned earlier. However, revenues at the DAMI segment are still expected to be \$30-\$35 million.

Aaron's Business' adjusted EBITDA is now anticipated to be \$155-\$160 million versus \$160-\$170 million mentioned earlier. EBITDA at the Progressive division is now envisioned to be \$275-\$280 million compared with \$275-\$285 million mentioned earlier. For the DAMI segment, management continues to project adjusted EBITDA of negative \$3-\$5 million.

For 2019, management now expects adjusted earnings of \$3.75-\$3.85 per share, down from \$3.85-\$4.00 stated earlier.

Recent News

Aaron's Hikes Dividend – Nov 5, 2019

Aaron's hiked its quarterly cash dividend by 14.3% to 4 cents per share, from the prior payout of 3.5 cents per share. The raised dividend is payable Jan 6, 2020 to shareholders of record as on Dec 19.

Valuation

Aaron's shares are up 24.3% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Retail-Wholesale sector are up 42% and 17.1% over the past year, respectively.

The S&P 500 index is up 22.2% in the past year.

The stock is currently trading at 13.49X forward 12-month earnings, which compares to 13.76X for the Zacks sub-industry, 25.46X for the Zacks sector and 18.96X for the S&P 500 index.

Over the past five years, the stock has traded as high as 18.17X and as low as 8.74X, with a 5-year median of 13.14X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$63 price target reflects 14.11X forward 12-month earnings.

The table below shows summary valuation data for AAN

Valuation Multiples - AAN					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	13.49	13.76	25.46	18.96
	5-Year High	18.17	13.76	26.23	19.34
	5-Year Low	8.74	8.32	19.07	15.17
	5-Year Median	13.14	11.59	22.95	17.44
P/S F12M	Current	0.92	0.39	1.08	3.53
	5-Year High	1.21	0.41	1.11	3.53
	5-Year Low	0.42	0.21	0.8	2.54
	5-Year Median	0.77	0.31	0.91	3
EV/EBITDA TTM	Current	1.74	6.6	15.47	12.12
	5-Year High	2.45	6.61	15.47	12.86
	5-Year Low	1.09	2.91	10.37	8.48
	5-Year Median	1.76	4.41	12.38	10.67

As of 01/16/2020

Industry Analysis Zacks Industry Rank: Bottom 3% (246 out of 254)



Top Peers

RH (RH)	Outperform
Best Buy Co., Inc. (BBY)	Neutral
Big Lots, Inc. (BIG)	Neutral
GameStop Corp. (GME)	Neutral
Rent-A-Center, Inc. (RCII)	Neutral
Systemax Inc. (SYX)	Neutral
Walmart Inc. (WMT)	Neutral
Conns, Inc. (CONN)	Underperform

Industry Comparison Industry: Retail - Consumer Electronics				Industry Peers		
	AAN Neutral	X Industry	S&P 500	BBY Neutral	CONN Underperform	SYX Neutral
VGM Score	A	-	-	A	B	B
Market Cap	4.05 B	304.56 M	24.61 B	23.02 B	301.75 M	961.55 M
# of Analysts	8	4	13	9	5	1
Dividend Yield	0.27%	0.00%	1.74%	2.25%	0.00%	1.87%
Value Score	A	-	-	A	A	C
Cash/Price	0.04	0.17	0.04	0.05	0.17	0.10
EV/EBITDA	2.03	7.61	14.24	9.25	7.61	13.71
PEG Ratio	0.82	0.74	2.07	1.72	0.20	NA
Price/Book (P/B)	2.17	1.27	3.38	7.50	0.48	5.80
Price/Cash Flow (P/CF)	1.97	2.70	13.75	10.55	2.70	18.54
P/E (F1)	13.69	14.27	19.09	14.97	4.66	17.19
Price/Sales (P/S)	1.03	0.78	2.68	0.53	0.19	1.02
Earnings Yield	7.37%	6.68%	5.24%	6.68%	21.48%	5.82%
Debt/Equity	0.19	0.36	0.72	1.10	2.04	0.36
Cash Flow (\$/share)	30.66	3.64	6.94	8.43	3.89	1.38
Growth Score	A	-	-	C	C	B
Hist. EPS Growth (3-5 yrs)	15.96%	20.38%	10.56%	21.97%	20.38%	70.69%
Proj. EPS Growth (F1/F0)	16.54%	14.63%	7.57%	11.72%	-10.04%	11.19%
Curr. Cash Flow Growth	20.03%	15.57%	14.73%	11.12%	58.97%	-3.38%
Hist. Cash Flow Growth (3-5 yrs)	20.01%	15.62%	9.00%	9.54%	2.04%	61.41%
Current Ratio	2.74	1.77	1.24	1.05	4.92	1.77
Debt/Capital	15.67%	39.46%	42.99%	52.39%	67.13%	26.53%
Net Margin	5.09%	5.21%	11.14%	3.54%	5.37%	5.32%
Return on Equity	14.21%	14.05%	17.16%	49.43%	13.89%	33.72%
Sales/Assets	1.26	1.69	0.55	2.91	0.76	2.25
Proj. Sales Growth (F1/F0)	11.07%	1.54%	4.16%	1.54%	0.83%	5.17%
Momentum Score	F	-	-	C	C	B
Daily Price Chg	0.97%	0.03%	0.89%	0.03%	1.94%	1.75%
1 Week Price Chg	1.32%	0.00%	0.39%	3.98%	-6.98%	-1.24%
4 Week Price Chg	1.83%	0.00%	2.65%	0.35%	-15.75%	-1.65%
12 Week Price Chg	-19.69%	-12.50%	7.55%	23.34%	-58.80%	5.04%
52 Week Price Chg	27.17%	27.17%	22.12%	53.84%	-45.63%	7.87%
20 Day Average Volume	498,957	35,938	1,536,375	1,862,290	1,156,887	54,371
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.48%	-0.48%	0.00%	0.00%	-5.36%	0.00%
(F1) EPS Est 12 week change	-1.96%	-4.08%	-0.40%	3.42%	-17.35%	-4.08%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	A
Growth Score	A
Momentum Score	F
VGM Score	A

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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