

Raising Price Target

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*Decor/Leisure/
Self Improvement*

Aaron Rents, Inc. (RNT-\$21.77)

Buy (1)

Company Statistics

12-month Price Target:	\$26
52-wk Range:	\$13.27-\$29.70
Market Capitalization (M):	\$1,180
Shares Outstanding (M) fd:	54.2
Avg. Daily Vol. (000):	470
Dividend:	\$0.06
Yield:	0.29%
Debt/Total cap:	18.1%
Est. 3-yr. EPS Growth:	18.0%
Tangible Book Value:	\$10.63
Price/Tangible Book Value:	2.0x

Financials

FYE Dec	2005A	2006A	2007A	2008E	2009E
P/E Ratio:	16.5x	14.8x	15.2x	14.4x	12.2x
EBITDA (M):	\$36.9	\$8.0	\$577.3	\$46.8	\$7.7
FCF/sh:	(\$1.34)	(\$0.38)	(\$0.60)	\$1.75	\$2.34
EPS:					
Q1	\$0.36	\$0.42	\$0.48	\$0.46A	\$0.53
Q2	\$0.32	\$0.39	\$0.36	\$0.38	\$0.45
Q3	\$0.17	\$0.32	\$0.29	\$0.32	\$0.38
Q4	\$0.47	\$0.35	\$0.28	\$0.35	\$0.43
Total	\$1.32	\$1.47	\$1.43	\$1.51	\$1.79
Prior EPS:					
Q1	--	--	--	--	--
Q2	--	--	--	\$0.37	--
Q3	--	--	--	\$0.32	--
Q4	--	--	--	\$0.36	--
Total	--	--	--	\$1.50	\$1.77
Revenue (M):					
Q1	\$279.3	\$347.3	\$383.0	\$437.3	\$470.0
Q2	\$271.3	\$321.7	\$359.0	\$402.9	\$449.9
Q3	\$278.7	\$317.7	\$359.4	\$391.6	\$437.8
Q4	\$305.2	\$339.9	\$388.6	\$408.1	\$451.7
Total	\$1,126	\$1,327	\$1,490	\$1,640	\$1,809

Company Description

Aaron Rents, Inc., is among the largest rental-purchase home furnishings retailers in the United States. Based in Atlanta and founded in 1955, as of March 30, 2008, the company had 1,579 stores throughout the United States.

RNT: TWEAKING UP Q2 EPS AND PRICE TARGET

Key Points

- Rent-to-Own Business Remains Solid.** Based on a variety of sources, including industry contacts, trade publications, and competitors' comments, we think the rent-to-own business remains solid in Q2 despite macro headwinds for U.S. consumers. One macro positive is the strength of the television business, which was roughly 30% of Aaron's FY'07 sales, and has a strong product cycle driven by flat panel and digital technology. In addition, we think tax rebate checks are a modest positive for rent-to-own operators, because many consumers are applying rebates to their outstanding rentals as well as other consumer debts. In addition, while gas and food prices are a negative for consumers, especially the lower end of the rent-to-own customer base, rent-to-own operators are seeing new consumers at the higher end, they hypothesize triggered by constraints on conventional consumer credit.
- Tweaking Aaron's Sales and EPS to Reflect Q2 Positives.** To reflect this business strength, we are raising our Q2'08 sales and EPS assumptions on Aaron's slightly. Our new Q2 sales assumption is \$402.9M, up from \$395M in our previous model but still slightly below Q2 guidance of \$405M. We are also tweaking our Q2 EPS estimate up slightly to \$0.38 from \$0.37, at the higher end of \$0.35-\$0.39 Q2 guidance. Q2 consensus is \$0.36 on revenue of \$404.6M. Also due to early contract payouts from rebate checks, we are slightly lowering our Q4 revenue estimate by roughly \$2M to \$408M and EPS by \$0.01 to \$0.35. This assumes some portion of customers who pay down an Aaron's contract in Q2 decline the opportunity to lease additional items this year. Aaron has not provided Q4 guidance, but FY'08 guidance is EPS of \$1.45-\$1.55 on revenue of \$1.7B. Our new FY'08 EPS estimate is \$1.51 on revenue of \$1.64B.
- Still Expect H2 Profit Ramp from Maturing Stores.** We continue to expect Aaron's EPS growth to accelerate later this year, with operating expense leverage from new-store maturation as a key driver, combined with continued strong execution from Aaron and a stable macro environment for the rent-to-own business with negatives such as gas prices balanced by positives such as consumer credit constraints. By Q4'08, we expect operating margins to expand by close to 100 bps from last year. We expect operating margin expansion to continue into FY'09 as Aaron maintains a moderate rate of store growth, not repeating the accelerated 2007 store opening schedule that has pressured margins for several quarters now. See page 2 for more detail on Aaron's earnings assumptions, including the profit improvement from store maturation.
- Tweaking up Price Target to \$26.** Using, we think, a reasonable P/E of 17x and our new FY 08 EPS of \$1.51, we are raising our PT on RNT's shares to \$26. Our old \$24 target was based on 16x FY 08 EPS of \$1.50.

Additional Discussion

Tweaking Aaron's Sales and EPS to Reflect Q2 Positives. To reflect industry strength, we are raising our Q2 sales and EPS assumptions on Aaron's slightly. Our new sales assumption is \$402.9M, up from \$395M in our previous model but still slightly below Q2 guidance of \$405M. Of this increase, \$1M is coming in franchise royalties, which we think we had modeled too low based on the past several quarters' strong trends in franchise comp sales, unit growth, and increasing average royalty rates. The remaining \$4M is due to the assumption of rebate checks impacting company-owned stores. We are still very conservative in "other" revenue, which we are modeling \$1M below last year due to volatility in that revenue stream. We are also tweaking Q2 EPS up slightly to \$0.38 from \$0.37, at the higher end of \$0.35–\$0.39 Q2 guidance. This EPS assumes a slightly lower blended gross margin than our previous model, because early contract payouts have a lower gross margin than full-term rentals. Q2 consensus is \$0.36 on revenue of \$404.6M.

Also due to early contract payouts from rebate checks, we are slightly lowering Q4 revenue by roughly \$2M to \$408M and EPS by \$0.01 to \$0.35. This assumes some portion of customers who pay down an Aaron's contract in Q2 decline the opportunity to lease additional items this year. Aaron has not provided Q4 guidance, but FY'08 guidance is EPS of \$1.45–\$1.55 on revenue of \$1.7B. Our new FY'08 EPS is \$1.51 on revenue of \$1.64B.

We still model operating margins reversing a six quarter trend of declines by Q4'08, primarily due to new 2007 stores beginning their second year of operations. Historically, Aaron's stores have had a store level operating loss of 20% in their first year of operation, improving to a 9% operating contribution in year 2, and increasing to 18% by year 5.

FIGURE 1. Aaron Rents Operating Margin, Bps Change in Operating Margin, and % Change in Store Count, 2005–2008E

2006 FYE 12/31/06	2007				2007 FY 12/31/07	2008E				2008E FYE 12/30/08
	Q1 3/31/07	Q2 6/30/07	Q3 9/30/07	Q4 12/31/07		Q1 3/30/08	Q2E 6/29/08	Q3E 9/29/08	Q4E 12/30/08	
10.1%	11.5%	9.3%	7.7%	7.1%	8.9%	9.8%	8.4%	7.4%	8.0%	8.5%
117	55	(135)	(165)	(253)	(125)	(166)	(94)	(21)	96	(43)
12.0%	14.1%	15.7%	19.6%	19.3%	19.3%	16.6%	15.0%	9.3%	3.5%	3.5%

Source: Company reports and BB&TCM estimates

Thus we continue to assume operating margin contracts in Q2'08–Q3'08, albeit at a lesser rate than during late FY'07, due to new store pressures. We expect the operating margin trend to swing positive in Q4'08 and into FY'09 as all new late FY'08 and early FY'08 stores enter their second year of operations. Store maturation, combined with a more modest pace of new store openings, is the key driver of our EPS acceleration modeling for Aaron, with no expectation of economic improvement in the near future. Our FY'08 assumption for comp sales is that they remain relatively stable in the low-single-digit positive range, with the TV product cycle, store maturation, and consumer credit constraints as positives to comps and economic factors such as gas prices and employment negatives to comps.

Valuation Methodology and Risks. We like to value retail/consumer stocks relative to earnings growth rates, and we see Aaron Rents sustaining earnings growth in the high teens or better from a combination of new store openings, same-store sales gains, and margin gains. Since March 2004, RNT has traded in a P/E range of 14.7x–23.3x forward earnings and at an average of 18.6x, which we believe is reasonable for a retail/consumer stock with a high-teens or better estimated EPS growth rate. We assume Aaron's P/E will expand this year from the low end of this range, as earnings growth accelerates from new store maturation. Assuming a P/E of 17x our FY'08 EPS estimate of \$1.51, our price target is \$26.

We believe **risks** to achieving our price target include those typically faced by other retailers, such as weather and natural disasters, competition, management change, and economic factors—especially unemployment, for Aaron Rents customers. In the rent-to-own industry, government regulation and litigation are also a risk, although Aaron's consumer-friendly policies make it less of a target of the media, politicians, and regulators than other players, in our opinion.

Aaron Rents (RNT)

Historical and Projected Income Statement

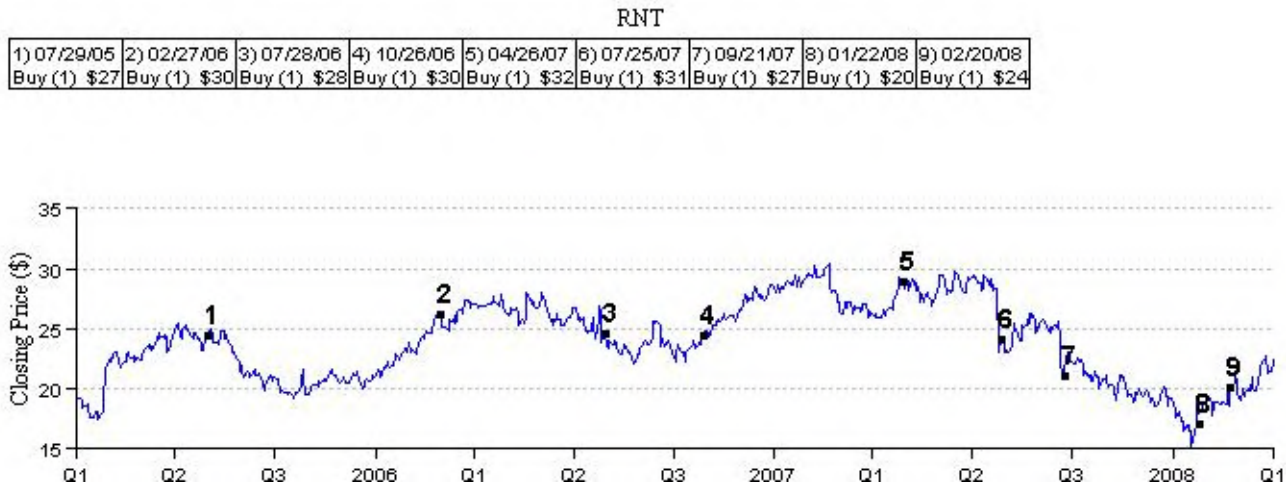
(FYE Dec., \$ millions except per share data)

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	2006	2007				2007	2008E				2008E	2009E				2009E
	FYE 12/31/06	Q1 3/31/07	Q2 6/30/07	Q3 9/30/07	Q4 12/31/07	FY 12/31/07	Q1 3/30/08	Q2E 6/29/08	Q3E 9/29/08	Q4E 12/30/08	FYE 12/30/08	Q1E 3/30/09	Q2E 6/29/09	Q3E 9/29/09	Q4E 12/30/09	FYE 12/30/09
Rentals & Fees	\$992.8	\$285.8	\$277.9	\$278.1	\$285.0	\$1,126.8	\$319.8	\$318.4	\$305.0	\$301.9	\$1,245.2	\$345.9	\$361.1	\$344.2	\$340.5	\$1,391.5
Retail Sales	62.3	15.6	12.5	12.8	13.6	54.5	17.1	13.8	13.8	14.0	58.8	19.3	15.5	15.4	15.5	65.7
Non-Retail Sales	224.5	70.3	56.7	58.1	76.5	261.6	85.4	59.4	62.6	78.1	285.5	93.6	62.7	67.4	81.1	304.8
Other	47.0	11.4	11.9	10.3	13.5	47.1	14.9	11.3	10.1	14.0	50.3	11.3	10.7	10.9	14.6	47.5
Net Sales	1326.6	383.0	359.0	359.4	388.6	1490.0	437.3	402.9	391.6	408.1	1639.9	470.0	449.9	437.8	451.7	1809.4
Retail Cost of Sales	41.3	10.3	8.5	8.4	8.9	36.1	11.0	9.4	9.1	9.3	38.8	12.5	10.6	10.2	10.3	43.6
Non-Retail Cost of Sales	714.0	205.5	197.3	196.6	207.4	806.8	234.8	223.3	214.9	218.8	891.9	252.9	251.2	241.2	244.4	989.8
Depreciation of Rental Merch.	364.1	103.1	101.1	101.3	101.9	407.3	113.6	115.8	111.1	108.0	448.4	122.8	131.3	125.4	121.7	501.2
Total Cost of Sales	612.6	177.5	161.7	162.8	181.2	683.2	202.5	179.6	176.6	189.3	748.0	217.1	198.7	196.5	207.3	819.6
Gross Profit	714.0	205.5	197.3	196.6	207.4	806.8	234.8	223.3	214.9	218.8	891.9	252.9	251.2	241.2	244.4	989.8
Operating Expenses	579.6	161.7	163.8	169.1	179.9	674.4	192.0	189.4	185.8	186.0	753.3	204.9	210.2	206.4	204.6	826.2
Income from operations	134.4	43.9	33.5	27.5	27.5	132.4	42.8	33.9	29.1	32.8	138.6	47.9	41.0	34.8	39.8	163.6
Interest income (expense)	-9.7	-1.9	-1.9	-2.2	-2.5	-8.5	-2.4	-2.1	-2.4	-2.6	-9.6	-2.6	-2.4	-2.7	-2.9	-10.6
Income before income taxes	124.7	42.0	31.6	25.3	25.0	123.9	40.4	31.7	26.8	30.1	129.0	45.3	38.7	32.2	36.9	153.0
Income tax expense	46.1	15.7	12.0	9.4	9.5	46.6	15.6	11.3	9.5	10.7	47.1	16.1	13.7	11.4	13.1	54.3
Net Income	78.6	26.2	19.6	15.9	15.5	77.3	24.8	20.5	17.3	19.4	81.9	29.2	24.9	20.7	23.8	98.7
Diluted Shares	53.4	54.2	54.2	55.0	54.8	54.1	54.2	54.3	54.4	54.9	54.4	55.0	55.1	55.2	55.7	55.2
EPS (diluted)	\$1.47	\$0.48	\$0.36	\$0.29	\$0.28	\$1.43	\$0.46	\$0.38	\$0.32	\$0.35	\$1.51	\$0.53	\$0.45	\$0.38	\$0.43	\$1.79
% of Sales																
Rentals & Fees	74.8%	74.6%	77.4%	77.4%	73.3%	75.6%	73.1%	79.0%	77.9%	74.0%	75.9%	73.6%	80.3%	78.6%	75.4%	76.9%
Retail Sales	4.7%	4.1%	3.5%	3.6%	3.5%	3.7%	3.9%	3.4%	3.5%	3.4%	3.6%	4.1%	3.4%	3.5%	3.4%	3.6%
Non-Retail Sales	16.9%	18.3%	15.8%	16.2%	19.7%	17.6%	19.5%	14.7%	16.0%	19.1%	17.4%	19.9%	13.9%	15.4%	18.0%	16.8%
Other Inc. (Exp.)	3.5%	3.0%	3.3%	2.9%	3.5%	3.2%	3.4%	2.8%	2.6%	3.4%	3.1%	2.4%	2.4%	2.5%	3.2%	2.6%
Gross margin	53.8%	53.7%	55.0%	54.7%	53.4%	54.1%	53.7%	55.4%	54.9%	53.6%	54.4%	53.8%	55.8%	55.1%	54.1%	54.7%
bps chg	(20)	131	(12)	21	(13)	33	3	46	19	26	24	11	42	21	49	31
Total operating expense	43.7%	42.2%	45.6%	47.1%	46.3%	45.3%	43.9%	47.0%	47.5%	45.6%	45.9%	43.6%	46.7%	47.2%	45.3%	45.7%
bps chg	(137)	76	123	186	239	158	169	140	40	(70)	67	(30)	(30)	(30)	(28)	
Operating Income	10.1%	11.5%	9.3%	7.7%	7.1%	8.9%	9.8%	8.4%	7.4%	8.0%	8.5%	10.2%	9.1%	8.0%	8.8%	9.0%
bps chg	117	55	(135)	(165)	(253)	(125)	(166)	(94)	(21)	96	(43)	41	72	51	79	
Pretax Margin	9.4%	11.0%	8.8%	7.0%	6.4%	8.3%	9.2%	7.9%	6.8%	7.4%	7.9%	9.6%	8.6%	7.3%	8.2%	8.5%
Net Margin	5.9%	6.8%	5.5%	4.4%	4.0%	5.2%	5.7%	5.1%	4.4%	4.8%	5.0%	6.2%	5.5%	4.7%	5.3%	5.5%
bps chg	(4)	64	(95)	(104)	(162)	(74)	(119)	(39)	(2)	78	(19)	56	46	33	51	46
yr/yr % change																
Net Sales	17.9%	10.3%	11.6%	13.1%	14.3%	12.3%	14.2%	12.2%	9.0%	5.0%	10.1%	7.5%	11.7%	11.8%	10.7%	10.3%
Operating income	33.3%	15.9%	-2.5%	-6.9%	-15.8%	-1.5%	-2.4%	1.0%	6.0%	19.2%	4.7%	11.9%	21.2%	19.5%	21.5%	18.1%
Pre-tax income	35.1%	21.2%	-0.1%	-8.4%	-18.8%	-0.6%	-3.8%	0.3%	5.7%	20.7%	4.1%	12.2%	21.8%	20.1%	22.5%	18.6%
Net income	17.1%	21.7%	-5.0%	-8.4%	-18.6%	-1.7%	-5.7%	4.3%	8.4%	25.5%	6.0%	18.1%	21.8%	20.1%	22.5%	20.5%
Shares	5.0%	6.0%	2.8%	0.5%	-0.1%	1.3%	0.0%	0.1%	-1.3%	0.1%	0.6%	1.5%	1.5%	1.5%	1.5%	1.5%
EPS	11.5%	14.8%	-7.6%	-8.9%	-18.5%	-3.0%	-5.6%	4.2%	9.8%	25.3%	5.3%	16.4%	20.1%	18.4%	20.7%	18.8%
RTO comp store sales	8.5%	5.4%	5.0%	4.0%	3.9%	4.6%	4.6%	3.5%	3.6%	3.3%	3.3%	4.0%	4.0%	4.0%	4.0%	4.0%
# RTO stores	12.0%	14.1%	15.7%	19.6%	19.3%	19.3%	16.6%	15.0%	9.3%	3.5%	3.5%	12.5%	11.8%	11.2%	11.0%	11.0%
# franchised stores	12.5%	12.8%	11.8%	7.5%	9.5%	9.5%	7.1%	10.4%	13.3%	7.5%	7.5%	9.5%	5.6%	7.6%	3.9%	3.9%

IMPORTANT DISCLOSURES

Price Chart



BB&T Capital Markets' rating distribution by percentage (as of March 31, 2008):

All companies under coverage:		All companies under coverage to which it has provided investment banking services in the previous 12 months:	
Buy (1)	46.7%	Buy (1)	10.2%
Hold (2)	51.8%	Hold (2)	4.9%
Underweight/Sell (3)	1.5%	Underweight/Sell (3)	0.0%
Not Rated (NR)	0.0%	Not Rated (NR)	0.0%
Suspended (SP)	0.0%	Suspended (SP)	0.0%

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The definition of each rating is as follows:

- Buy (1): estimated total return potential greater than or equal to 10%
- Hold (2): estimated total return potential greater than or equal to 0% and less than 10%
- Underweight (3): estimated total return potential less than 0%

- NR: Not Rated
- NA: Not Applicable
- NM: Not Meaningful
- SP: Suspended

Stocks rated Buy (1) are required to have a published 12-month price target, while it is not required on stocks rated Hold (2) and Underweight (3).

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Company	Disclosure
Aaron Rents, Inc. (RNT)	6, 9

ADDITIONAL INFORMATION IS AVAILABLE UPON REQUEST

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