AARON'S INC
Form 10-K
February 25, 2011

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2010
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. 1-13941
AARON S, INC.
(Exact name of registrant as specified in its charter)

GEORGIA	**58-0687630**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
309 E. PACES FERRY ROAD, N.E. ATLANTA, GEORGIA	**30305-2377**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: **(404) 231-0011**
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $.50 Par Value	**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act: **NONE**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

Large Accelerated Filer þ Accelerated Filer o Non-Accelerated Filer o Smaller Reporting Company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No þ

Aggregate market value of the voting and non-voting common stock held by non-affiliates of the registrant as of June 30, 2010, the last business day of the registrant s most recently completed second fiscal quarter, based on the closing sale prices of the registrant s common shares as reported by the New York Stock Exchange on such date: $1,225,387,962. Subsequent to June 30, 2010, the registrant s non-voting shares were converted into voting shares on a one-for-one basis. See Item 12.

The number of shares outstanding of the registrant s class of common stock, as of February 24, 2011, was as follows:

TITLE OF EACH CLASS	**SHARES OUTSTANDING AS OF FEBRUARY 24, 2011**
Common Stock, $.50 Par Value	80,132,070

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive Proxy Statement for the 2011 annual meeting of shareholders are incorporated by reference into Part III of this Form 10-K.

Table of Contents

CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS

Certain oral and written statements made by Aaron s, Inc. about future events and expectations, including statements in this annual report on Form 10-K, are forward-looking statements. For those statements we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. Forward-looking statements are based on management s current beliefs, assumptions and expectations regarding our future economic performance, taking into account the information currently available to management. Generally, the words anticipate, believe, estimate, expect, intend, project, and similar expressions identify forward-looking statements, which generally are not historical in nature. All statements which address operating performance, events or developments that we expect or anticipate will occur in the future, including growth in store openings, franchises awarded, market share and statements expressing general optimism about future operating results, are forward-looking statements. Forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from the company s historical experience and the company s present expectations or projections. Factors that could cause our actual results to differ materially from any forward-looking statements include changes in general economic conditions, competition, pricing, customer demand and those factors discussed in Item 1A, Risk Factors. We qualify any forward-looking statements entirely by these cautionary factors.

The above mentioned risk factors are not all-inclusive. Given these uncertainties and that such statements speak only as of the date made, you should not place undue reliance on forward-looking statements. We undertake no obligation to update publicly or revise any forward-looking statements, whether as a result of new information, future events, changes in assumptions or otherwise.

PART I.

ITEM 1. BUSINESS

General

Aaron s, Inc. (we , our , us , Aaron s or the Company) is a leading specialty retailer of consumer electronics, con residential furniture, household appliances and accessories. We engage in the lease ownership, lease and retail sale of a wide variety of products such as widescreen and LCD televisions, computers, living room, dining room and bedroom furniture, washers, dryers and refrigerators. We carry well-known brands such as JVC®, Mitsubishi®, Philips®, Panasonic®, Sony®, Dell®, Hewlett-Packard®, Simmons®, Frigidaire®, and Sharp®. Our major operating divisions are the Aaron s Sales & Lease Ownership division and the Woodhaven Furniture Industries division (formerly MacTavish Furniture Industries division), which supplies the majority of the upholstered furniture and bedding leased and sold in our stores. Our strategic focus is on expanding our sales and lease ownership business through opening new company-operated stores, expanding our franchise program, and making selective acquisitions.

As of December 31, 2010, we had 1,813 sales and lease ownership stores, comprised of 1,149 company-operated stores in 30 states and Canada and 664 independently-owned franchised stores in 48 states and Canada. We have added 304 company-operated and 223 franchised sales and lease ownership stores since the beginning of 2006. Included in the sales and lease ownership store counts above are 11 company-operated and six franchised RIMCO stores, our wheels, tires and accessories sales and lease ownership concept. We also have one office furniture store.

During the fourth quarter of 2008 the Company sold substantially all of the assets of its Aaron s Corporate Furnishings division, which leased residential furniture, office furniture and related accessories through 47 company-operated stores in 16 states, to CORT Business Services Corporation (CORT). As a result of the sale, our financial statements have been prepared reflecting the Aaron s Corporate Furnishings division as discontinued operations.

We have a history of revenue growth and profitability. Total revenues increased to $1.877 billion in 2010 from $1.228 billion in 2006, representing an 11.2% compound annual growth rate. Our total net earnings from continuing operations increased to $118.4 million in 2010 from $70.9 million in 2006 representing a 13.7% compound annual growth rate.

Our Chairman, R. Charles Loudermilk, Sr., established Aaron s in 1955, and we were incorporated under the laws of Georgia in 1962. Our principal business address is 309 E. Paces Ferry Road, N.E., Atlanta, Georgia, 30305-2377, and our telephone number is (404) 231-0011.

We own or have rights to various trademarks and trade names used in our business.

Aaron s Sales & Lease Ownership. Our sales and lease ownership division focuses on providing durable household goods to lower to middle income consumers who have limited or no access to traditional credit sources such as bank financing, installment credit or credit cards. Our sales and lease ownership program enables these customers to obtain quality-of-life enhancing merchandise that they might otherwise not be able to afford, without incurring additional debt or long-term obligations.

Our strategic focus is to expand our Aaron s Sales & Lease Ownership division by opening company-operated stores, expanding our franchise program and making selective acquisitions. We franchise our sales and lease ownership stores in select markets where we have no immediate plans to enter. Our franchise program:

- provides additional revenues from franchise fees and royalties;
- allows us to grow more quickly;
- enables us to achieve economies of scale in purchasing, distribution, manufacturing and advertising for our sales and lease ownership stores; and
- increases exposure to our brand.

Aaron s Office Furniture. After disappointing results in a difficult environment, in June 2010 we announced plans to close all of the then 12 remaining the Aaron s Office Furniture stores and focus solely on the Company s sales and lease ownership business. Since June 2010, we closed 11 of the Aaron s Office Furniture stores and have one remaining store open to liquidate merchandise. During 2010 we recorded $9.0 million in charges related to write-down and cost to dispose of office furniture, estimated future lease liabilities for closed stores, write-off of leaseholds, severance pay, and other costs associated with closing the stores and, closing down the division. We do not anticipate incurring significant charges in the future related to winding down the division.

Woodhaven Furniture Industries. Aaron s is the only major furniture lease company in the United States that manufactures its own furniture. We operate five furniture manufacturing plants and seven bedding manufacturing facilities. By manufacturing our own specially designed residential furniture and bedding, we believe we enjoy an advantage over our competitors. Manufacturing enables us to control the quality, cost, delivery, styling, durability and quantity of our furniture products.

HomeSmart. During the second half of 2010, we opened three company-operated stores under the HomeSmart name. These stores offer weekly payment lease agreements for products which are similar to those in our sales and lease ownership stores.

Industry Overview

The Rent-to-Own Industry

The rent-to-own industry offers customers an alternative to traditional methods of obtaining electronics, computers, home furnishings and appliances. In a typical rent-to-own transaction, the customer has the option to acquire merchandise over a fixed term, usually 12 to 24 months, normally by making weekly lease payments. The customer may cancel the agreement at any time by returning the merchandise to the store, generally with no further lease obligation. If the customer leases the item to the full term, he obtains ownership of the item, though he can choose to buy it at any time.

The rent-to-own concept is particularly popular with consumers who cannot pay the full purchase price for merchandise at once or who lack the credit to qualify under conventional financing programs. Rent-to-own is also popular with consumers who, despite good credit, do not wish to incur additional debt, have only a temporary need for the merchandise or want to try out a particular brand or model before buying it.

We believe that the decline in the number of furniture stores and the limited number of retailers that focus on credit installment sales to lower and middle income consumers has created a market opportunity for our unique sales and lease ownership concept. The traditional retail consumer durable goods market is much larger than the lease market, leaving substantial potential for growth for our sales and lease ownership division. We believe that the segment of the population targeted by our sales and lease ownership division comprises approximately 50% of all households in the United States and that the needs of these consumers are generally underserved.

Aaron s Sales & Lease Ownership versus Traditional Rent-to-Own

We believe that our sales and lease ownership model is unique. By providing customers with the option either to lease merchandise with the opportunity to obtain ownership or to purchase merchandise outright, we blend elements of rent-to-own and traditional retailing. We believe our sales and lease ownership program is a more effective method of retailing our merchandise to lower to middle income consumers than a typical rent-to-own business or the more traditional method of credit installment sales.

Table of Contents

Our sales and lease ownership model is distinctive from a typical rent-to-own business in that we encourage our customers to obtain ownership of their lease merchandise. Based upon industry data, we believe that when merchandise is initially leased our customers obtain ownership move (over 46%) versus rent-to-own businesses in general (approximately 25%). We believe our sales and lease ownership model offers the following unique characteristics versus traditional rent-to-own stores:

- ***Lower total cost*** our agreement terms typically provide a lower cost of ownership to the customer.
- ***Wider merchandise selection*** we generally offer a larger selection of higher-quality merchandise.
- ***Larger store layout*** our stores are typically 9,000 square feet, nearly twice the size of typical rent-to-own stores.
- ***Fewer payments*** our typical plan offers semi-monthly or monthly payments versus the industry standard of weekly payments. Our agreements also usually provide for a shorter term until the customer obtains ownership.
- ***Flexible payment methods*** we offer our customers the opportunity to pay by cash, check, credit card or debit card, compared with the more common cash payment method at typical rent-to-own stores. We receive approximately 53% of our payment volume (in dollars) from customers by check, credit card or debit card. We also accept online payments.

We believe our sales and lease ownership model also has attractive features in common with traditional retailers. Among these features are store size, merchandise selection and the latest product offerings, such as state-of-the-art electronics and computers. As technology has advanced and home furnishings and appliances have evolved, we have strived to offer our customers the latest product developments at affordable prices.

Unlike transactions with most traditional retailers, where the customer is committed to purchase the merchandise, our sales and lease ownership transactions are not credit installment contracts, and the customer may elect to terminate the transaction after a short initial lease period. Our sales and lease ownership stores offer an up-front cash and carry purchase option on most merchandise at prices that are competitive with traditional retailers.

Operating Strategies

Our operating strategies are focused on differentiation from our competitors and improved efficiencies. We strive to:

- ***Differentiate our Aaron s Sales & Lease Ownership concept*** We believe that the success of our sales and lease ownership operation is attributable to our distinctive approach to the business that sets us apart from our rent-to-own and credit retail competitors. We have pioneered innovative approaches to meeting changing customer needs that differ from our competitors , such as offering lease ownership agreements which result in a lower all-in price, larger and more attractive store showrooms, a wider selection of higher-quality merchandise and up-front cash and carry purchase options on select merchandise at prices that are competitive with traditional retailers. Most sales and lease ownership customers make their payments in person, and we use these frequent visits to strengthen customer relationships and make these customers feel welcome in our stores.
- ***Offer high levels of customer service and satisfaction*** We foster good relationships with our customers to attract recurring business and encourage them to lease merchandise for the full agreement term by providing high levels of service and satisfaction. We demonstrate our commitment to superior customer service by providing customers quick delivery of leased merchandise, in many cases by same or next day delivery, and repair service at no charge to the customer. We have also established an employee training program called Aaron s E-University, which is a 60-course curriculum designed to enhance the customer relations skills of both company-operated and franchised store managers.
- ***Promote our vendors and the Aaron s® brand name*** Our marketing initiatives reach the target Aaron s customer in a variety of ways. We advertise our brand name Dream Products through our Drive Dreams Home sponsorship of NASCAR Championship Racing. Sponsorship of other sporting events, such as professional football, basketball and baseball, and various college sports, also targets this distinct market. Every month, we distribute mass mailings of promotional material outlining specific products. Our goal is to reach households within a specified radius of each store on a consistent basis every month. Currently, we mail over 26 million flyers each month to consumers in areas served by our stores. We also utilize national

and local television and radio advertising in our markets and for special promotions throughout the year.

Table of Contents

Manage merchandise through our manufacturing and distribution capabilities We believe that our manufacturing operations and network of 17 fulfillment centers at December 31, 2010 give us a strategic advantage over our competitors. Manufacturing enables us to control the quality, cost, delivery, styling, durability and quantity of a substantial portion of our furniture merchandise, and provides us a reliable source of furniture. Our distribution system allows us to deliver merchandise promptly to our stores in order to meet customer demand quickly and manage inventory levels more effectively.

Utilize proprietary management information systems We use proprietary computerized information systems to systematically pursue collections, to manage merchandise returns and to match inventory with demand. Each of our stores, including franchised sales and lease ownership stores, is linked by computer directly to our corporate headquarters, which enables us to monitor the performance of each store on a daily basis.

Growth Strategies

We seek to increase our revenues and profitability through the execution of our growth strategies, which are to:

Open additional company-operated sales and lease ownership stores We plan to open sales and lease ownership stores in existing and select new geographic markets. Additional stores help us to realize economies of scale in purchasing, marketing and distribution. We added a net of 67 company-operated sales and lease ownership stores in 2010.

Increase our sales and lease ownership franchises We believe that our franchise program allows us to grow more quickly and increase our brand exposure in new markets. In addition, the combination of company-operated and franchised stores creates a larger store base that generally enhances the economies of scale in purchasing, distribution, manufacturing and advertising for our sales and lease ownership stores. Franchise fees and royalties represent a growing source of company revenues.

Increase revenues and net earnings from existing sales and lease ownership stores We experienced same store revenue growth (revenues earned in stores open for the entirety of both periods) from our company-operated sales and lease ownership stores of 3.5% in 2010, 8.1% in 2009, and 3.1% in 2008. We calculate same store revenue growth by comparing revenues from comparable periods for all stores open during the entirety of those periods, excluding stores that received lease agreements from other acquired, closed or merged stores. We expect revenues and net earnings of our sales and lease ownership division to continue to grow as the large number of stores we have opened in the past few years increase their customer bases.

Seek selective acquisitions in both new and existing sales and lease ownership markets We will continue to explore acquisitions of other rent-to-own operations and select company franchised stores. In 2010, we acquired the lease agreements, merchandise and assets of 30 sales and lease ownership stores. Eleven of these stores were subsequently merged with existing locations and five stores were sold to franchisees, resulting in 14 new stores from acquisitions. We will also seek to convert the stores of existing independent lease operators to Aaron s Sales & Lease Ownership franchised stores. In 2010, we sold ten of our sales and lease ownership stores to franchisees and one to a third party operator.

Operations

Sales and Lease Ownership

We established our Aaron s Sales & Lease Ownership operation in 1987. At December 31, 2010, we had 1,149 company-operated sales and lease ownership stores in 30 states and Canada.

We have developed a distinctive concept for our sales and lease ownership stores with specific merchandising, store layout, pricing and agreement terms for our target customer market. We believe that these features create a store and a sales and lease ownership concept significantly different from the operations of typical rent-to-own stores and corporate furnishings (rent-to-rent) businesses, and the operations of consumer electronics and home furnishings retailers who finance merchandise.

Table of Contents

The typical Aaron s Sales & Lease Ownership store layout is a combination showroom and warehouse of 8,000 to 10,000 square feet, with an average of approximately 9,000 total square feet. In selecting locations for new sales and lease ownership stores, we generally look for sites in well-maintained strip shopping centers with good access, which are strategically located in established working class neighborhoods and communities. We also build to suit or occupy stand-alone stores in certain markets. Many of our stores are placed near existing competitors stores. Each sales and lease ownership store usually maintains at least two trucks and crews for pickups and deliveries and generally offers same or next day delivery for addresses located within approximately ten miles of the store. We emphasize a broad selection of brand name electronics, computers and appliances, and offer customers a wide selection of furniture, including furniture manufactured by our Woodhaven Furniture Industries division.

We believe that our sales and lease ownership stores offer lower merchandise prices than similar items offered by traditional rent-to-own operators, and substantially equivalent to the all-in contract price of similar items offered by retailers who finance merchandise. Approximately 90% of our sales and lease ownership agreements are monthly and approximately 10% are semi-monthly as compared to the industry standard of weekly agreements, and our agreements usually provide for a shorter term leading to customer ownership. Customers can have the item serviced free of charge or replaced at any time during the lease agreement. We re-lease or sell merchandise that customers return to us prior to the expiration of their agreements. We also offer, for select merchandise, an up-front cash and carry purchase option at prices that are competitive with traditional retailers.

During the latter part of 2004, we opened two experimental stores under the RIMCO name that lease automobile wheels, tires and rims to customers under sales and lease ownership agreements. Although the products offered are different, these stores are managed, monitored and operated similarly to our other sales and lease ownership stores. At December 31, 2010, we had 11 company-operated and six franchised RIMCO stores open.

Sales and Lease Ownership Franchise Program

We began franchising Aaron s Sales & Lease Ownership stores in select markets in 1992 and have continued to attract franchisees. Our franchised stores do not compete with company-operated stores, nor do we anticipate any such competition, as we mainly award franchises in markets where we have no operations and no current plans to enter. As of December 31, 2010, we had 664 franchised stores open and area development agreements with franchisees to open 282 stores in the future.

Franchisees are approved on the basis of the applicant s business background and financial resources. We generally seek franchisees who will enter into area development agreements for several stores, although some franchisees currently operate a single store. Most franchisees are involved in the day-to-day operations of the stores.

We enter into franchise agreements with our franchisees to govern the opening and operation of franchised stores. Under our current standard agreement, we require the franchisee to pay a franchise fee from $15,000 to $50,000 per store depending upon market size. Agreements are for a term of ten years, with one ten-year renewal option, and franchisees are obligated to remit to us royalty payments of 5% or 6% of the franchisee s weekly cash collections. The royalty payments increased from 5% to 6% for most franchise agreements entered into or renewed after December 31, 2002.

We assist each franchisee in selecting the proper site for each store. Because of the importance of location to the Aaron s Sales & Lease Ownership concept, one of our pre-opening directors visits the intended market and helps guide the franchisee through the selection process. Once a site is selected, we help in designing the floor plan, including the proper layout of the showroom and warehouse. In addition, we provide assistance in assuring that the design and decor of the showroom is consistent with our requirements. We also lease the exterior signage to the franchisee and assist with placing pre-opening advertising, ordering initial inventory and obtaining delivery vehicles.

We have an arrangement with several banks to provide financing to qualifying franchisees to assist with establishing and operating their stores. An inventory financing plan to provide franchisees with the capital to purchase inventory is the primary component of the financing program. For qualified established franchisees, we have arranged in some cases for these institutions to provide a revolving credit line to allow franchisees the flexibility to expand. We guarantee amounts outstanding under the franchisee financing programs.

8

Table of Contents

All franchisees are required to complete a comprehensive training program and to operate their franchised sales and lease ownership stores in compliance with our policies, standards and specifications, including such matters as decor, lease agreement terms, hours of operation, pricing and merchandise. Franchisees in general are not required to purchase their lease merchandise from our fulfillment centers, although most do so in order to take advantage of company sponsored financing, bulk purchasing discounts and favorable delivery terms.

Our internal audit department conducts operational audits of every company store a minimum of once per year with additional audits performed due to General Manager turnover, risk assessments, and failing audits. We also conduct annual financial audits of each franchise and an annual operational audit of each franchised store. In addition, our proprietary management information system links each company and franchised store to corporate headquarters.

Furniture Manufacturing

Our Woodhaven Furniture Industries division has manufactured furniture for our stores since 1971. The division has five furniture manufacturing plants and seven bedding manufacturing facilities totaling approximately 781,000 square feet in the aggregate, that supply the majority of our upholstered furniture and bedding. We currently have no plans to significantly expand our capacity.

Our Woodhaven Furniture Industries division manufactures:

- upholstered living-room furniture, including contemporary sofas, sofa beds, chairs and modular sofa and ottoman collections in a variety of natural and synthetic fabrics; and
- bedding, including standard sizes of mattresses and box springs.

Woodhaven has designed special features for the furniture it manufactures that we believe reduce production costs, enhance product durability, and improve the shipping process relative to furniture purchased from third parties. These features include:

- standardization of components;
- reduction of parts and features susceptible to wear or damage;
- more resilient foam;
- durable, soil-resistant fabrics and sturdy frames for longer life and higher residual value; and
- devices that allow sofas to stand on end for easier and more efficient transport.

Woodhaven also manufactures replacement covers of all styles and fabrics of its upholstered furniture for use in reconditioning lease return furniture.

The principal raw materials we use in furniture manufacturing are fabric, foam, fiber, wire-innerspring assemblies, plywood and hardwood. All of these materials are purchased in the open market from unaffiliated sources. We are not dependent on any single supplier, and none of the raw materials we use are in short supply.

Marketing and Advertising

In our sales and lease ownership operations, we rely heavily on national and local television advertising. We advertise nationally on television with a variety of commercials. All of our television commercials generally feature brand name furniture, electronics, appliances and computers. Aaron s has national broadcast partnerships with ESPN/ABC, SPEED Channel, TNT, TBS and Univision.

We believe we have garnered significant value from our sports marketing initiatives. We advertise and sponsor motorsports at various levels along with select professional and collegiate sports, such as NFL, NBA and MLB teams, and SEC and ACC college athletic programs, among others, whose fan base, match our customer demographic.

Our premier title sponsorship continues to be the Aaron s Dream Weekend at Talladega Superspeedway consisting of the Aaron s 499 NASCAR Sprint Cup Series Race and the Aaron s 312 NASCAR Nationwide Series Race. Both races are broadcast live on national television and are among the most watched events on the NASCAR circuit.

Table of Contents

We continue our sponsorship in 2011 of Michael Waltrip Racing with David Reutimann driving the Aaron s #00 Dream Machine for 30 of 36 races in the NASCAR Sprint Cup Series. We expect that team owner Michael Waltrip will also drive an Aaron s Dream Machine in select races in 2011.

All of our sports partnerships are integrated directly into advertising, promotional and marketing initiatives that have proven to significantly enhance the Company s brand awareness and customer loyalty.

Paces East Advertising, Aaron s in-house advertising and promotions department, distributes over 26 million direct circulars each month which highlight featured merchandise and demonstrate the cost advantage to consumers of sales and lease ownership over typical rent-to-own transactions.

Store Operations

Management. Our Aaron s Sales & Lease Ownership division has 12 regional vice presidents who are primarily responsible for monitoring individual store performance and inventory levels within their respective regions.

Stores are directly supervised by 122 sales and lease ownership regional managers, and two RIMCO regional managers. At the individual store level, the store manager is primarily responsible for overseeing:

- customer and credit relations;
- deliveries and pickups;
- warehouse and inventory management;
- hiring and terminating store employees; and
- certain marketing efforts.

Store managers are also responsible for inspecting lease return merchandise to determine whether it should be sold as is, leased again as is, repaired and sold, or reconditioned for additional lease. A significant portion of the store manager s compensation is dependent upon store revenues and profits.

Executive management directs and coordinates:

- purchasing;
- financial planning and control;
- franchise operations;
- marketing and advertising;
- manufacturing;
- employee training;
- new store site selection and construction for company-operated stores;
- long range and strategic planning;
- enterprise risk management;
- organizational issues; and
- acquisitions.

Our business philosophy has always emphasized safeguarding of company assets, strict cost containment and fiscal controls. Executive and store level management monitor expenses to contain costs. We pay all invoices from Company headquarters in order to enhance fiscal accountability. We believe that careful attention to the safeguarding of lease merchandise, our most significant asset, as well as the expense side of our operations, has enabled us to maintain financial stability and profitability.

Management Information Systems. We use computer-based management information systems to facilitate cash collections, merchandise returns and inventory monitoring. Through the use of proprietary software developed in-house, each of our stores is linked by computer directly to corporate headquarters, which enables us to monitor the performance of each store on a daily basis. At the store level, the store manager is better able to track merchandise on the showroom floor and in the warehouse to minimize delivery times, assist with product purchasing, and match customer needs with available inventory.

Table of Contents

Lease Agreement Approval, Renewal and Collection. One of the keys to the success of our sales and lease ownership operation is timely cash collections. Individual store managers track cash collections and customers are contacted within a few days of their lease payment due dates in order to encourage customers to keep their agreement current and in force, rather than having to return the merchandise for non-payment, and to renew their agreements for an additional period. Careful attention to cash collections is particularly important in sales and lease ownership operations, where the customer typically has the option to cancel the agreement at any time and each payment is considered a renewal of the agreement rather than a collection of a receivable.

We generally perform no formal credit check with respect to sales and lease ownership customers, other than to verify employment or other reliable sources of income and personal references supplied by the customer. All of our agreements for merchandise require payments in advance, and the merchandise normally is repossessed if a payment is significantly in arrears.

We do not extend credit to sales and lease ownership customers. Net company-wide merchandise shrinkage as a percentage of combined lease revenues was 2.5% in 2010 and 2.9% in 2009 and 2008. We believe that our collection and repossession policies comply with applicable legal requirements, and we discipline any employee that we discover deviating from such policies.

Customer Service. We believe that customer service is one of the most important elements in the success of our business. Customer satisfaction is critical because the customer typically has the option of returning the leased merchandise at any time. Our goal is to make our customers feel positive about Aaron s and our products from the moment they enter our showrooms. Items are serviced at no charge to the customer, and free delivery is available in many cases. In order to increase leasing at existing stores, we foster relationships with existing customers to attract recurring business, and many new agreements are attributable to repeat customers.

Because of the importance of customer service, we believe that a prerequisite for successful operations and growth is skilled, effective employees who value our customers and project a genuine desire to serve customers needs. Our Aaron s Sales & Lease Ownership division has developed one of the largest training programs in the industry, called Aaron s University. Aaron s University is designed to provide a uniform customer service experience regardless of the store s location, or whether it is company-operated or franchised. Standardizing operating procedures throughout our system is a primary focus of Aaron s University. Aaron s national trainers provide live interactive training via webinars on a daily basis to entry level and management level associates. The learning program is also complimented with a robust e-learning library with an ongoing constantly growing curriculum.

In addition to the e-learning program, Aaron s University has a management development program that offers facilities-based training for store management-caliber associates. Additionally, approximately once a month we distribute a DVD entitled Inside Aaron®.s These DVDs are intended to communicate a wide variety of topics of interest to our store personnel regarding current company initiatives. Our policy of primarily promoting from within boosts employee retention and underscores our commitment to customer service and other business philosophies, allowing us to realize greater benefits from our employee training programs.

Table of Contents

Purchasing and Distribution

Our product mix is determined by store managers in consultation with regional managers and regional vice presidents, based on an analysis of customer demands.

The following table shows the percentage of sales and lease ownership division revenues for the year ended December 31, 2010 attributable to different merchandise categories:

Merchandise Category	Percentage of 2010 Revenues	Percentage of 2009 Revenues	Percentage of 2008 Revenues
Electronics	37%	37%	35%
Furniture	31%	30%	30%
Appliances	16%	15%	15%
Computers	13%	14%	16%
Other	3%	4%	4%

We purchase the majority of our merchandise directly from manufacturers, with the balance from local distributors. One of our largest suppliers is our own Woodhaven Furniture Industries division, which supplies the majority of the upholstered furniture and bedding we lease or sell. We have no long-term agreements for the purchase of merchandise.

Sales and lease ownership operations utilize fulfillment centers, which are on average approximately 94,000 square feet, to control merchandise. All company-operated sales and lease ownership stores receive merchandise directly from our 17 fulfillment centers, together totaling approximately 1,778,000 square feet. Most of our continental United States stores are within a 250-mile radius of a fulfillment center, facilitating timely shipment of products to the stores and fast delivery of orders to customers.

We realize freight savings from truckload discounts and more efficient distribution of merchandise by using fulfillment centers. We use our own tractor-trailers, local delivery trucks and various contract carriers to make weekly deliveries to individual stores.

Competition

Aaron s business is highly competitive. Our largest competitor in the rent-to-own market is Rent-A-Center, Inc. According to industry sources and our estimates, Aaron s and Rent-A-Center, Inc., which are the two largest industry participants, account for approximately 4,900 of the 8,500 rent-to-own stores in the United States and Canada. Our stores compete with other national and regional rent-to-own businesses, as well as with rental stores that do not offer their customers a purchase option. With respect to customers desiring to purchase merchandise for cash or on credit, we also compete with retail stores. Competition is based primarily on store location, product selection and availability, customer service and lease rates and terms.

Seasonality

Aaron s revenue mix is moderately seasonal, with the first quarter of each year generally resulting in higher revenues than any other quarter during the year, primarily due to realizing the full benefit of business that historically gradually increases in the fourth quarter as a result of the holiday season, as well as the receipt by our customers in the first quarter of federal income tax refunds. Generally, our customers will more frequently exercise the early purchase option on their existing lease agreements or purchase merchandise off the showroom floor during the first quarter of the year. We expect this trend to continue in future periods. Furthermore, we tend to experience slower growth in the number of agreements on lease in the third quarter of each year when compared to the other quarters of the year. We also expect this trend to continue in future periods unless we significantly change our store base as a result of new store openings or opportunistic acquisitions and dispositions.

Government Regulation

Our operations are extensively regulated by and subject to the requirements of various federal and state laws and regulations. In general such laws regulate applications for leases, late fees, other finance rates, the form of disclosure statements, the substance and sequence of required disclosures, the content of advertising materials and certain collection procedures. Violations of certain provisions of these laws may result in penalties ranging from nominal amounts up to and including forfeiture of fees and other amounts due on leases. We do not anticipate that the various laws and regulations have had or will have a material adverse effect on our operations. However, we are unable to predict the nature or effect on our operations or earnings of unknown future legislation, regulations and judicial decisions or future interpretations of existing and future legislation or regulations relating to our operations, and there can be no assurance that future laws, decisions or interpretations will not have a material adverse effect on our operations and earnings.

Table of Contents

A summary of certain of the state and federal laws under which we operate follows. This summary does not purport to be a complete summary of the laws referred to below or of all the laws regulating our operations.

Currently, 47 states and the District of Columbia specifically regulate rent-to-own transactions, including states in which we currently operate Aaron s Sales & Lease Ownership stores. Most state lease purchase laws require rent-to-own companies to disclose to their customers the total number of payments, total amount and timing of all payments to acquire ownership of any item, any other charges that may be imposed, and miscellaneous other items. The more restrictive state lease purchase laws limit the total amount that a customer may be charged for an item, or regulate the amount of deemed interest that rent-to-own companies may charge on rent-to-own transactions, generally defining interest as lease fees paid in excess of the retail price of the goods. Our long-established policy in all states is to disclose the terms of our lease purchase transactions as a matter of good business ethics and customer service. We believe we are in material compliance with the various state lease purchase laws in those states where we use a lease purchase form of agreement. At the present time, no federal law specifically regulates the rent-to-own industry. Federal legislation to regulate the industry has been proposed from time to time.

The current economic downturn has renewed legislative attention in the United States, at both the state and federal levels, on consumer debt transactions in general, which may result in an increase in legislative regulatory efforts directed at the rent-to-own industry. We cannot predict whether any such legislation will be enacted and what the impact of such legislation would be on us. Although we are unable to predict the results of any regulatory initiatives, we do not believe that existing and currently proposed regulations will have a material adverse impact on our sales and lease ownership or other operations.

We have introduced a form of consumer lease as an alternative to our typical lease purchase agreement in a number of states. The consumer lease differs from a lease purchase agreement in that it has an initial lease term in excess of four months. Generally, state laws that govern the rent-to-own industry only apply to lease agreements with an initial term of four months or less. The consumer lease is governed by federal and state laws and regulations other than the state lease purchase laws. The federal regulations applicable to the consumer lease require certain disclosures similar to the rent-to-own regulations, but are generally less restrictive as to pricing and other charges. We believe we are in material compliance with all laws applicable to our consumer leasing program.

Our sales and lease ownership franchise program is subject to Federal Trade Commission (FTC) regulation and various state laws regulating the offer and sale of franchises. Several state laws also regulate substantive aspects of the franchisor-franchisee relationship. The FTC requires us to furnish to prospective franchisees a franchise offering circular containing prescribed information. A number of states in which we might consider franchising also regulate the sale of franchises and require registration of the franchise offering circular with state authorities. We believe we are in material compliance with all applicable franchise laws in those states in which we do business and with similar laws in Canada.

Employees

At December 31, 2010, Aaron s had approximately 10,400 employees. None of our employees are covered by a collective bargaining agreement, and we believe that our relations with our employees are good.

Table of Contents

Information on Segments and Geographic Areas

We currently only operate in the United States and Canada. Information on our three reportable segments sales and lease ownership, franchise and manufacturing is set forth in Note K to our Consolidated Financial Statements. See Item 8 of Part II.

Available Information

We make available free of charge on or through our Internet website our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after we electronically file such material with, or furnish it to, the U.S. Securities and Exchange Commission (SEC). Our Internet address is *www.aaronsinc.com*.

ITEM 1A. RISK FACTORS

Aaron s business is subject to certain risks and uncertainties, the most significant of which are set forth below.

Our growth strategy depends considerably on opening new company-operated stores. Our ability to expand our store base is influenced by factors beyond our control, which may impair our growth strategy and impede our revenue growth.

Opening new company-operated stores is an important part of our growth strategy. Our ability to continue opening new stores is affected by, among other things:

- the substantial outlay of financial resources required to open new stores and initially operate them, and the availability of capital sources to finance new openings and initial operation;
- difficulties associated with hiring, training and retaining additional skilled personnel, including store managers;
- our ability to identify suitable new store sites and to negotiate acceptable leases for these sites;
- competition in existing and new markets;
- consumer demand, tastes and spending patterns in new markets that differ from those in our existing markets; and
- challenges in adapting our distribution and other operational and management systems to an expanded network of stores.

If we cannot address these challenges successfully, we may not be able to expand our business or increase our revenues at the rates we currently contemplate.

If we cannot manage the costs of opening new stores, our profitability may suffer.

Opening large numbers of new stores requires significant start-up expenses, and new stores are generally not profitable until their second year of operation. Consequently, opening many stores over a short period can materially decrease our net earnings for a time. This effect is sometimes called new store drag. During 2010, we estimate that start-up expenses for new stores reduced our net earnings by approximately $13 million or $.15 per diluted share. We cannot be certain that we will be able to fully recover these significant costs in the future.

We may not be able to attract qualified franchisees, which may slow the growth of our business.

Our growth strategy depends significantly upon our franchisees developing new franchised sales and lease ownership stores. We generally seek franchisees who meet our stringent business background and financial criteria, and who are willing to enter into area development agreements for several stores. A number of factors, however, could inhibit our ability to find qualified franchisees, including general economic downturns or legislative or litigation developments that make the rent-to-own industry less attractive to potential franchisees. These developments could also adversely affect our franchisees ability to obtain adequate capital to develop and operate new stores on time, or at all. Our inability to find qualified franchisees could slow our growth.

Qualified franchisees who conform to our standards and requirements are also important to the overall success of our business. Our franchisees, however, are independent contractors and not employees, and consequently we cannot and do not control them to the same extent as our company-operated stores. Our franchisees may fail in key areas, which could in turn slow our growth, reduce our franchise revenues or damage our image and reputation.

If we are unable to integrate acquired businesses successfully and realize anticipated economic, operational and other benefits in a timely manner, our profitability may decrease.

We frequently acquire other sales and lease ownership businesses. We acquired the lease agreements, merchandise and assets of 30 stores through acquisitions in 2010. If we are unable to integrate businesses we acquire successfully, we may incur substantial cost and delays in increasing our customer base. In addition, the failure to integrate acquisitions successfully may divert management s attention from Aaron s existing business. Integration of an acquired business may be more difficult when we acquire a business in an unfamiliar market, or a business with a different management philosophy or operating style.

Table of Contents

Our competitors could impede our ability to attract new customers, or cause current customers to cease doing business with us.

The industries in which we compete are highly competitive. In the sales and lease ownership market, our competitors include national, regional and local operators of rent-to-own stores and credit retailers. Our competitors in the sales and lease ownership and traditional retail markets may have significantly greater financial and operating resources, and greater name recognition in certain markets, than we have. Greater financial resources may allow our competitors to grow faster than us, including through acquisitions. This in turn may enable them to enter new markets before we can, which may decrease our opportunities in those markets. Greater name recognition, or better public perception of a competitor s reputation, may help them divert market share away from us, even in our established markets.

In addition, new competitors may emerge. Current and potential competitors may establish financial or strategic relationships among themselves or with third parties. Accordingly, it is possible that new competitors or alliances among competitors could emerge and rapidly acquire significant market share.

If our independent franchisees fail to meet their debt service payments or other obligations under outstanding loans guaranteed by us as part of a franchise loan program, amounts that the lenders participating in the program could require us to pay to satisfy these obligations could have a material adverse effect on our business and financial condition.

We have guaranteed the borrowings of certain franchisees under a franchise loan program with several banks with a maximum commitment amount of $200.0 million, and we also guarantee franchisee borrowings under certain other debt facilities. In the event these franchisees are unable to meet their debt service payments or otherwise experience an event of default, we would be unconditionally liable for a portion of the outstanding balance of the franchisees debt obligations, which at December 31, 2010 was $121.0 million. Of this amount, approximately $108.3 million represents franchisee borrowings outstanding under the franchise loan program and approximately $12.7 million represents franchisee borrowings that we guarantee under other debt facilities. Although we have had no significant losses associated with the franchisee loan and guaranty program since its inception, and we believe that any losses associated with any defaults would be mitigated through recovery of lease merchandise and other assets, we cannot guarantee that there will be no significant losses in the future or that we will be able to adequately mitigate any such losses. If we fail to adequately mitigate any such future losses, our business and financial condition could be materially adversely impacted.

Any loss of the services of our key executives, or our inability to attract and retain qualified managers, could have a material adverse impact on our operations.

We believe that we have benefited substantially from our current executive leadership and that the loss of their services at any time in the near future could adversely affect our business and operations. We also depend on the continued services of the rest of our management team. The loss of these individuals without adequate replacement could also adversely affect our business. Although we have employment agreements with the majority of our key executives, they are generally terminable on short notice and we do not carry key man life insurance on any of our officers.

Additionally, we need a growing number of qualified managers to operate our stores successfully. The inability to attract and retain qualified individuals, or a significant increase in the costs to do so, would materially adversely affect our operations.

Table of Contents

You should not rely solely on our same store revenues as an indication of our future results of operations because they fluctuate significantly.

Our historical same store revenue growth figures have fluctuated significantly from year to year. For example, we experienced same store revenue growth of 3.5% in 2010 and 8.1% in 2009. We calculate same store revenue growth by comparing revenues for comparable periods for all stores open during the entirety of those periods. Even though we achieved significant same store revenue growth in the past and consider it a key indicator of historical performance, we may not be able to increase same store revenues in the future. A number of factors have historically affected, and will continue to affect, our same store revenues, including:

- changes in competition;
- general economic conditions;
- new product introductions;
- consumer trends;
- changes in our merchandise mix;
- the opening of new stores;
- the impact of our new stores on our existing stores, including potential decreases in existing stores revenues as a result of opening new stores;
- timing of promotional events; and
- our ability to execute our business strategy effectively.

Changes in our quarterly and annual same store revenues could cause the price of our common stock to fluctuate significantly.

Our operations are regulated by and subject to the requirements of various federal and state laws and regulations. These laws and regulations, as the same may be amended or supplemented or interpreted by the courts from time to time, could expose us to significant compliance costs or burdens or force us to change our business practices in a manner that may be materially adverse to our operations, prospects or financial condition.

Currently 47 states and the District of Columbia specifically regulate rent-to-own transactions, including states in which we currently operate Aaron s Sales & Lease Ownership stores. At the present time, no federal law specifically regulates the rent-to-own industry, although federal legislation to regulate the industry has been proposed from time to time. Any adverse changes in existing laws, or the passage of new adverse legislation by states or the federal government could materially increase both our costs of complying with laws and the risk that we could be sued or be subject to government sanctions if we are not in compliance. In addition, new burdensome legislation might force us to change our business model and might reduce the economic potential of our sales and lease ownership operations.

Most of the states that regulate rent-to-own transactions have enacted disclosure laws which require rent-to-own companies to disclose to their customers the total number of payments, total amount and timing of all payments to acquire ownership of any item, any other charges that may be imposed by them and miscellaneous other items. The more restrictive state lease purchase laws limit the total amount that a customer may be charged for an item, or regulate the amount of deemed interest that rent-to-own companies may charge on rent-to-own transactions, generally defining interest as lease fees paid in excess of the retail price of the goods.

The current economic downturn has renewed legislative attention in the United States, at both the state and federal levels, on consumer debt transactions in general, which may result in an increase in legislative regulatory efforts directed at the rent-to-own industry. We cannot guarantee that the federal government or states will not enact additional or different legislation that would be disadvantageous or otherwise materially adverse to us, nor can we guaranty that Canadian law will not be enacted that would be materially adverse to us.

In addition to the risk of lawsuits related to the laws that regulate rent-to-own and consumer lease transactions, we could be subject to lawsuits alleging violations of federal and state or Canadian provincial laws and regulations and consumer tort law, including fraud and consumer protection laws, because of the consumer-oriented nature of the rent-to-own industry. A large judgment could adversely affect our financial condition and results of operations. Moreover, an adverse outcome from a lawsuit, even one against one of our competitors, could result in changes in the way we and others in the industry do business, possibly leading to significant costs or decreased revenues or profitability.

Table of Contents

Continuation or deepening of current economic conditions could result in decreased revenues or increased costs.

The United States and other economies are currently experiencing severe distress, accompanied by disruptions and contraction in the credit markets and broad unemployment. Although we believe the economic downturn has resulted in increased business in our sales and lease ownership stores, as consumers increasingly find it difficult to purchase home furnishings, electronics and appliances from traditional retailers on store installment credit, it is possible that if the conditions continue for a significant period of time, or get worse consumers may curtail spending on all or some of the types of merchandise we offer, in which event our revenues may suffer.

In addition, unemployment may result in increased defaults on lease payments, resulting in increased merchandise return costs and merchandise losses.

Disruptions in the credit and capital markets may negatively affect our access to capital.

We have historically relied partially on the credit and capital markets to fund our growth, including through bank loan arrangements and periodic public stock offering and private placements of debt securities. Beginning in the second half of 2008, the global credit and capital markets experienced severe disruptions, resulting in increased costs of capital, and unavailability of some forms of capital. Although the credit and capital markets have improved somewhat, they have not recovered to their pre-crisis strength. While we believe our sources of capital will be adequate to fund our operations for the next 24 months, if credit and capital market disruptions continue for an extended period, or deteriorate further, we may not be able to obtain capital at favorable costs, and may not be able to obtain some forms of capital at all.

We are subject to laws that regulate franchisor-franchisee relationships. Our ability to develop new franchised stores and enforce our rights against franchisees may be adversely affected by these laws, which could impair our growth strategy and cause our franchise revenues to decline.

As a franchisor, we are subject to regulation by the Federal Trade Commission, state laws and certain Canadian provincial laws regulating the offer and sale of franchises. Because we plan to expand our business in part by selling more franchises, our failure to obtain or maintain approvals to sell franchises could significantly impair our growth strategy. In addition, our failure to comply with franchise regulations could cause us to lose franchise fees and ongoing royalty revenues. Moreover, state and provincial laws that regulate substantive aspects of our relationships with franchisees may limit our ability to terminate or otherwise resolve conflicts with our franchisees.

We are subject to legal proceedings from time to time which seek material damages.