Student Investment Fund

Consumer Discretionary Group

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Trade Recommendation for AAN

The Consumer Discretionary group for the University of Oklahoma is writing this document to recommend selling the Fund’s 846 shares in Aaron’s Inc. The groups analyst report on Aaron’s is located on the next page.



Date: November 10, 2020 Forward P/E: 11.19

Company Ticker: AAN Sector Forward P/E: 9.70

Sector: Consumer Discretionary Market Price: $60.60

Industry: Household Durables Forecasted Price: $29.77

**Recommendation: Sell**

**Company Summary**

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

**Industry Outlook**

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

**Earnings Forecast**

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



**Valuation**

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





**Sensitivity Analysis**

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



**Conclusion**

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