

AARON RENTS INC  
Form 10-Q  
November 07, 2007

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2007  
OR**

☐ **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 RENTS, INC.  
(Exact name of registrant as specified in its charter)**

**Georgia**  
(State or other jurisdiction of  
incorporation or organization)

**58-0687630**  
(I. R. S. Employer  
Identification No.)

**309 E. Paces Ferry Road, N.E.**  
**Atlanta, Georgia**  
(Address of principal executive offices)

**30305-2377**  
(Zip Code)

**(404) 231-0011**  
(Registrant's telephone number, including area code)

**Not Applicable**  
(Former name, former address and former  
fiscal year, if changed since last report)

Indicate by check mark whether 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 ☒ No ☐  
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer ☐ Accelerated Filer ☐ Non-Accelerated Filer ☐

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| <b>Title of Each Class</b>            | <b>Shares Outstanding as of<br/>November 5, 2007</b> |
|---------------------------------------|------------------------------------------------------|
| Common Stock, \$.50 Par Value         | 45,852,418                                           |
| Class A Common Stock, \$.50 Par Value | 8,396,233                                            |



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**PART I FINANCIAL INFORMATION**  
**Item 1 Financial Statements**  
**AARON RENTS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

|                                                                                                                                                             | (Unaudited)<br>September<br>30,<br>2007<br>(In Thousands, Except Share<br>Data) | December<br>31,<br>2006 |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------|-------------------------|
| <b>ASSETS:</b>                                                                                                                                              |                                                                                 |                         |
| Cash                                                                                                                                                        | \$ 9,723                                                                        | \$ 8,807                |
| Accounts Receivable (net of allowances of \$3,950 in 2007 and \$3,037 in 2006)                                                                              | 46,065                                                                          | 43,495                  |
| Rental Merchandise                                                                                                                                          | 972,996                                                                         | 925,534                 |
| Less: Accumulated Depreciation                                                                                                                              | (358,764)                                                                       | (313,385)               |
|                                                                                                                                                             | 614,232                                                                         | 612,149                 |
| Property, Plant and Equipment, Net                                                                                                                          | 226,981                                                                         | 170,294                 |
| Goodwill, Net                                                                                                                                               | 135,407                                                                         | 112,046                 |
| Other Intangibles, Net                                                                                                                                      | 4,826                                                                           | 3,390                   |
| Prepaid Expenses and Other Assets                                                                                                                           | 40,273                                                                          | 29,425                  |
| Total Assets                                                                                                                                                | \$ 1,077,507                                                                    | \$ 979,606              |
| <b>LIABILITIES &amp; SHAREHOLDERS EQUITY:</b>                                                                                                               |                                                                                 |                         |
| Accounts Payable and Accrued Expenses                                                                                                                       | \$ 135,465                                                                      | \$ 121,018              |
| Dividends Payable                                                                                                                                           | 813                                                                             | 811                     |
| Deferred Income Taxes Payable                                                                                                                               | 91,317                                                                          | 93,687                  |
| Customer Deposits and Advance Payments                                                                                                                      | 26,770                                                                          | 27,101                  |
| Credit Facilities                                                                                                                                           | 152,491                                                                         | 129,974                 |
| Total Liabilities                                                                                                                                           | 406,856                                                                         | 372,591                 |
| Commitments & Contingencies                                                                                                                                 |                                                                                 |                         |
| Shareholders Equity:                                                                                                                                        |                                                                                 |                         |
| Common Stock, Par Value \$.50 Per Share; Authorized: 100,000,000<br>Shares; Shares Issued: 48,439,602 at September 30, 2007 and<br>December 31, 2006        | 24,220                                                                          | 24,220                  |
| Class A Common Stock, Par Value \$.50 Per Share; Authorized: 25,000,000<br>Shares; Shares Issued: 12,063,856 at September 30, 2007 and<br>December 31, 2006 | 6,032                                                                           | 6,032                   |
| Additional Paid-in Capital                                                                                                                                  | 187,435                                                                         | 183,966                 |
| Retained Earnings                                                                                                                                           | 484,486                                                                         | 424,991                 |
| Accumulated Other Comprehensive Loss                                                                                                                        | (125)                                                                           |                         |

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|                                                                    |              |            |
|--------------------------------------------------------------------|--------------|------------|
|                                                                    | 702,048      | 639,209    |
| Less: Treasury Shares at Cost,                                     |              |            |
| Common Stock, 2,616,487 Shares at September 30, 2007 and 2,696,781 |              |            |
| Shares at December 31, 2006                                        | (15,493)     | (16,290)   |
| Class A Common Stock, 3,667,623 Shares at September 30, 2007 and   |              |            |
| December 31, 2006                                                  | (15,904)     | (15,904)   |
| Total Shareholders' Equity                                         | 670,651      | 607,015    |
| Total Liabilities & Shareholders' Equity                           | \$ 1,077,507 | \$ 979,606 |

The accompanying notes are an integral part of the Consolidated Financial Statements

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**AARON RENTS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF EARNINGS**  
(Unaudited)

|                                                                      | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|----------------------------------------------------------------------|-------------------------------------|------------|------------------------------------|------------|
|                                                                      | 2007                                | 2006       | 2007                               | 2006       |
|                                                                      | (In Thousands, Except Share Data)   |            |                                    |            |
| <b>REVENUES:</b>                                                     |                                     |            |                                    |            |
| Rentals and Fees                                                     | \$ 278,104                          | \$ 243,649 | \$ 841,828                         | \$ 743,689 |
| Retail Sales                                                         | 12,808                              | 14,330     | 40,948                             | 49,432     |
| Non-Retail Sales                                                     | 58,140                              | 49,429     | 185,047                            | 159,813    |
| Franchise Royalties and Fees                                         | 8,881                               | 8,322      | 28,397                             | 24,770     |
| Other                                                                | 1,448                               | 1,979      | 10,080                             | 9,019      |
|                                                                      | 359,381                             | 317,709    | 1,106,300                          | 986,723    |
| <b>COSTS AND EXPENSES:</b>                                           |                                     |            |                                    |            |
| Retail Cost of Sales                                                 | 8,389                               | 9,553      | 27,180                             | 32,826     |
| Non-Retail Cost of Sales                                             | 53,095                              | 45,210     | 169,355                            | 148,308    |
| Operating Expenses                                                   | 169,105                             | 143,601    | 494,519                            | 430,375    |
| Depreciation of Rental Merchandise                                   | 101,299                             | 89,806     | 305,413                            | 273,408    |
| Interest                                                             | 2,180                               | 1,914      | 5,965                              | 7,860      |
|                                                                      | 334,068                             | 290,084    | 1,002,432                          | 892,777    |
| <b>EARNINGS BEFORE INCOME TAXES</b>                                  | 25,313                              | 27,625     | 103,868                            | 93,946     |
| <b>INCOME TAXES</b>                                                  | 9,394                               | 10,242     | 39,085                             | 34,352     |
| <b>NET EARNINGS</b>                                                  | \$ 15,919                           | \$ 17,383  | \$ 64,783                          | \$ 59,594  |
| <b>COMMON STOCK AND CLASS A COMMON STOCK EARNINGS PER SHARE:</b>     |                                     |            |                                    |            |
| Basic                                                                | \$ .29                              | \$ .32     | \$ 1.20                            | \$ 1.15    |
| Assuming Dilution                                                    | .29                                 | .32        | 1.18                               | 1.13       |
| <b>CASH DIVIDENDS DECLARED PER SHARE:</b>                            |                                     |            |                                    |            |
| Common Stock                                                         | \$ .015                             | \$ .014    | \$ .045                            | \$ .042    |
| Class A Common Stock                                                 | .015                                | .014       | .045                               | .042       |
| <b>COMMON STOCK AND CLASS A COMMON STOCK WEIGHTED AVERAGE SHARES</b> |                                     |            |                                    |            |

**OUTSTANDING:**

|                   |        |        |        |        |
|-------------------|--------|--------|--------|--------|
| Basic             | 54,217 | 53,989 | 54,190 | 52,034 |
| Assuming Dilution | 55,049 | 54,767 | 55,046 | 52,874 |

The accompanying notes are an integral part of the Consolidated Financial Statements

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**AARON RENTS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)

|                                                                                | Nine Months Ended<br>September 30, |           |
|--------------------------------------------------------------------------------|------------------------------------|-----------|
|                                                                                | 2007                               | 2006      |
|                                                                                | (In Thousands)                     |           |
| <b>OPERATING ACTIVITIES:</b>                                                   |                                    |           |
| Net Earnings                                                                   | \$ 64,783                          | \$ 59,594 |
| Depreciation and Amortization                                                  | 332,229                            | 296,762   |
| Additions to Rental Merchandise                                                | (511,504)                          | (458,676) |
| Book Value of Rental Merchandise Sold or Disposed                              | 218,490                            | 186,429   |
| Change in Deferred Income Taxes                                                | (2,370)                            | 19,622    |
| (Gain) Loss on Sale of Property, Plant, and Equipment                          | (4,653)                            | 98        |
| Gain on Asset Disposition                                                      |                                    | (4,425)   |
| Change in Income Tax Receivable, Included in Prepaid Expenses and Other Assets |                                    | (3,373)   |
| Change in Accounts Payable and Accrued Expenses                                | 14,120                             | 4,840     |
| Change in Accounts Receivable                                                  | (2,570)                            | 1,471     |
| Excess Tax Benefits from Stock-Based Compensation                              | (397)                              | (3,288)   |
| Other Changes, Net                                                             | (12,091)                           | (775)     |
| Cash Provided by Operating Activities                                          | 96,037                             | 98,279    |
| <b>INVESTING ACTIVITIES:</b>                                                   |                                    |           |
| Additions to Property, Plant and Equipment                                     | (96,746)                           | (53,715)  |
| Proceeds from Sale of Property, Plant, and Equipment                           | 21,575                             | 22,636    |
| Contracts and Other Assets Acquired                                            | (42,573)                           | (22,976)  |
| Proceeds from Contracts and Other Assets Sold                                  |                                    | 11,626    |
| Cash Used in Investing Activities                                              | (117,744)                          | (42,429)  |
| <b>FINANCING ACTIVITIES:</b>                                                   |                                    |           |
| Proceeds from Credit Facilities                                                | 329,988                            | 225,898   |
| Repayments on Credit Facilities                                                | (307,471)                          | (322,617) |
| Dividends Paid                                                                 | (2,436)                            | (2,166)   |
| Proceeds from Stock Offering                                                   |                                    | 83,999    |
| Excess Tax Benefits from Stock-Based Compensation                              | 397                                | 3,288     |
| Issuance of Stock Under Stock Option Plans                                     | 2,145                              | 3,456     |
| Cash Provided by (Used in) Financing Activities                                | 22,623                             | (8,142)   |
| Increase in Cash                                                               | 916                                | 47,708    |
| Cash at Beginning of Period                                                    | 8,807                              | 6,973     |
| Cash at End of Period                                                          | \$ 9,723                           | \$ 54,681 |

The accompanying notes are an integral part of the Consolidated Financial Statements

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**AARON RENTS, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**NINE MONTHS ENDED SEPTEMBER 30, 2007**  
(Unaudited)

**Note A Basis of Presentation**

The consolidated financial statements include the accounts of Aaron Rents, Inc. (the Company) and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

The consolidated balance sheet as of September 30, 2007, the consolidated statements of earnings for the quarter and nine months ended September 30, 2007 and 2006, and the consolidated statements of cash flows for the nine months ended September 30, 2007 and 2006, are unaudited. The preparation of interim consolidated financial statements requires management to make estimates and assumptions that affect the amounts reported in these financial statements and accompanying notes. Management does not believe these estimates or assumptions will change significantly in the future absent unsurfaced or unforeseen events. Generally, actual experience has been consistent with management's prior estimates and assumptions; however, actual results could differ from those estimates.

The financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair presentation of the results for the interim periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted. We suggest you read these financial statements in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission for the year ended December 31, 2006. The results of operations for the quarter ended September 30, 2007, are not necessarily indicative of operating results for the full year.

Certain reclassifications have been made to the prior periods to conform to the current period presentation. In previous years' cash flow presentations, \$2.6 million of construction in progress has been reclassified to additions of property, plant and equipment and proceeds from sale of property, plant and equipment.

*Accounting Policies and Estimates*

See Note A to the consolidated financial statements in the 2006 Annual Report on Form 10-K.

*Rental Merchandise*

See Note A to the consolidated financial statements in the 2006 Annual Report on Form 10-K. Rental merchandise adjustments for the three-month periods ended September 30 were \$7.6 million in 2007 and \$3.8 million in 2006. Rental merchandise adjustments for the nine-month periods ended September 30 were \$20.7 million in 2007 and \$13.8 million in 2006. These charges are recorded as a component of operating expenses.

*Goodwill and Other Intangibles*

During the nine months ended September 30, 2007, the Company recorded \$23.4 million in goodwill, \$2.1 million in customer relationship intangibles, and \$1.1 million in acquired franchise development rights in connection with a series of acquisitions of sales and lease ownership businesses. Customer relationship intangibles are amortized on a straight-line basis over their estimated useful lives of two years. Amortization expense was \$608,000 and \$741,000 for the three-month periods ended September 30, 2007 and 2006, respectively. Amortization expense was \$1.8 million and \$1.7 million for the nine-month periods ended September 30, 2007 and 2006, respectively. The aggregate purchase price for these asset acquisitions totaled \$42.6 million, with the principal tangible assets acquired consisting of rental merchandise and certain fixtures and equipment. These purchase price allocations are tentative and preliminary; the Company anticipates finalizing them prior to December 31, 2007. The results of operations of the acquired businesses are included in the Company's results of operations from the dates of acquisition and are not significant.

*Stock Compensation*

See Note H to the consolidated financial statements in the 2006 Annual Report on Form 10-K. The results of operations for the three months ended September 30, 2007 and 2006 include \$458,000 and \$907,000, respectively,

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in compensation expense related to stock option grants. The results of operations for the nine months ended September 30, 2007 and 2006 include \$1.6 million and \$2.8 million, respectively, in compensation expense related to stock option grants. Additionally, the results of operations for the three and nine months ended September 30, 2007 include \$450,000 and \$1.3 million, respectively, in compensation expense related to restricted stock awards. The Company did not grant or modify any stock options or stock awards in the nine months ended September 30, 2007.

### *Income Taxes*

The Company adopted the provisions of the Financial Accounting Standards Board's (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* (FIN 48), on January 1, 2007. FIN 48 clarifies the accounting and reporting for uncertainties in income tax law and prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken on income tax returns. As a result of the implementation of FIN 48, the Company recognized a \$2.9 million increase in the liability for uncertain tax benefits, which was accounted for as a reduction to the January 1, 2007 balance of retained earnings. The Company has a \$3.3 million liability recorded for uncertain tax benefits as of January 1, 2007, which includes interest and penalties of \$400,000. The Company recognizes interest and penalties accrued related to uncertain tax benefits in tax expense. The total amount of uncertain tax benefits that, if recognized, would affect the effective tax rate is \$3.3 million. The Company does not currently anticipate that the total amount of uncertain tax benefits will significantly increase or decrease by the end of 2007. The Company and its subsidiaries file a consolidated federal income tax return in the U.S. at the federal level, and the separate legal entities file in various states and foreign jurisdictions. The Company is no longer subject to U.S. federal examinations by tax authorities for years before 2003 or non-U.S. income tax examinations by tax authorities for years before 2002 and, with few exceptions, examinations by state and local authorities before 2003.

### *Sales Taxes*

In March 2006, the FASB Emerging Issues Task Force issued Issue 06-03, *How Sales Taxes Collected From Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement* (EITF 06-03). A consensus was reached that entities may adopt a policy of presenting sales taxes in the income statement on either a gross or net basis. If sales taxes are significant, an entity should disclose its policy of presenting sales taxes. The Company presents revenues net of sales taxes. EITF 06-03 is effective for periods beginning after December 15, 2006. Adoption on January 1, 2007, did not have an effect on the Company's policy related to sales taxes and therefore did not have an effect on the Company's consolidated financial statements.

### **Note B Credit Facilities**

See Note D to the consolidated financial statements in the 2006 Annual Report on Form 10-K. On February 27, 2007, the Company amended the franchise loan facility and guaranty to increase the maximum commitment amount from \$115.0 million to \$125.0 million. On May 29, 2007, the Company entered into a franchise loan facility and guaranty with a bank to guarantee the borrowings of certain independent RIMCO (the Company's custom wheel rim and related services sales and lease ownership concept) franchisees. The maximum commitment amount under this program is \$3.5 million.

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Comprehensive income is comprised of the net earnings of the Company, foreign currency translation adjustments, and the changes in unrealized gains or losses on available-for-sale securities, net of income taxes, as summarized below:

| (In Thousands)                                         | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|--------------------------------------------------------|-------------------------------------|-----------|------------------------------------|-----------|
|                                                        | 2007                                | 2006      | 2007                               | 2006      |
| Net earnings                                           | \$ 15,919                           | \$ 17,383 | \$ 64,783                          | \$ 59,594 |
| Other comprehensive income:                            |                                     |           |                                    |           |
| Foreign currency translation adjustment                | (8)                                 |           | (37)                               |           |
| Unrealized loss on marketable securities, net of taxes |                                     |           | (88)                               | (14)      |
| Total other comprehensive loss                         | (8)                                 |           | (125)                              | (14)      |
| Comprehensive Income                                   | \$ 15,911                           | \$ 17,383 | \$ 64,658                          | \$ 59,580 |

**Note D Segment Information**

| (In Thousands)                                       | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|------------------------------------------------------|-------------------------------------|------------|------------------------------------|------------|
|                                                      | 2007                                | 2006       | 2007                               | 2006       |
| <b>Revenues From External Customers:</b>             |                                     |            |                                    |            |
| Sales and Lease Ownership                            | \$ 314,755                          | \$ 279,313 | \$ 974,245                         | \$ 865,682 |
| Corporate Furnishings                                | 29,710                              | 30,396     | 91,527                             | 93,766     |
| Franchise                                            | 8,881                               | 8,322      | 28,397                             | 24,770     |
| Other                                                | 2,580                               | 1,750      | 10,067                             | 4,728      |
| Manufacturing                                        | 16,439                              | 17,244     | 57,403                             | 56,914     |
| Elimination of Intersegment Revenues                 | (16,491)                            | (17,187)   | (57,429)                           | (56,683)   |
| Cash to Accrual Adjustments                          | 3,507                               | (2,130)    | 2,090                              | (2,454)    |
| Total Revenues from External Customers               | \$ 359,381                          | \$ 317,708 | \$ 1,106,300                       | \$ 986,723 |
| <b>Earnings Before Income Taxes:</b>                 |                                     |            |                                    |            |
| Sales and Lease Ownership                            | \$ 14,588                           | \$ 22,166  | \$ 72,431                          | \$ 73,149  |
| Corporate Furnishings                                | 2,013                               | 2,775      | 8,068                              | 10,016     |
| Franchise                                            | 6,431                               | 5,829      | 20,884                             | 17,804     |
| Other                                                | (743)                               | (1,252)    | 2,148                              | (4,722)    |
| Manufacturing                                        | (106)                               | (385)      | (740)                              | (1,532)    |
| Earnings Before Income Taxes for Reportable Segments | 22,183                              | 29,133     | 102,791                            | 94,715     |
| Elimination of Intersegment Profit                   | 140                                 | 385        | 854                                | 1,612      |
| Cash to Accrual and Other Adjustments                | 2,990                               | (1,893)    | 223                                | (2,381)    |
| Total Earnings Before Income Taxes                   | \$ 25,313                           | \$ 27,625  | \$ 103,868                         | \$ 93,946  |

Earnings before income taxes for each reportable segment are generally determined in accordance with accounting principles generally accepted in the United States with the following adjustments:

A predetermined amount of approximately 2.3% of each reportable segment's revenues is charged to the reportable segment as an allocation of corporate overhead.

Accruals related to store closures are not recorded on the reportable segment's financial statements, but are rather maintained and controlled by corporate headquarters.

The capitalization and amortization of manufacturing and distribution variances are recorded in the consolidated financial statements as part of Cash to Accrual and Other Adjustments and are not allocated to the segment that holds the related rental merchandise.

Advertising expense in the sales and lease ownership division is estimated at the beginning of each year and then allocated to the division ratably over time for management reporting purposes. For financial

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reporting purposes, advertising expense is recognized when the related advertising activities occur. The difference between these two methods is reflected as part of Cash to Accrual and Other Adjustments. Sales and lease ownership rental merchandise write-offs are recorded using the direct write-off method for management reporting purposes. For financial reporting purposes, the allowance method is used and is reflected as part of Cash to Accrual and Other Adjustments.

Interest on borrowings is estimated at the beginning of each year. Interest is then allocated to operating segments on the basis of relative total assets.

Sales and lease ownership revenues are reported on a cash basis for management reporting purposes. Revenues in the Other category are primarily from leasing space to unrelated third parties in the corporate headquarters building and revenues from several minor unrelated activities. The pre-tax earnings items in the Other category are the net result of the profits and losses from leasing a portion of the corporate headquarters and several minor unrelated activities, and the portion of corporate overhead not allocated to the reportable segments for management purposes. Additionally, included in the Other category is a \$4.9 million gain from the sale of a parking deck at the Company's corporate headquarters in the first quarter of 2007. Included in the sales and lease ownership revenues for the second quarter of 2006 was a \$4.4 million gain from the sale of the assets of our 12 stores located in Puerto Rico.

### **Note E Recent Accounting Pronouncements**

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 establishes a framework for measuring the fair value of assets and liabilities which is intended to provide increased consistency in how fair value determinations are made under various existing accounting standards. SFAS 157 also expands financial statement disclosure requirements about the use of fair value measurements, including the effect of such measures on earnings. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those years. The Company is currently evaluating the impact of this Statement on its financial statements.

### **Note F Commitments**

The Company leases warehouse and retail store space for substantially all of its operations under operating leases expiring at various times through 2024. Most of the leases contain renewal options for additional periods ranging from one to 15 years or provide for options to purchase the related property at predetermined purchase prices that do not represent bargain purchase options. The Company also leases transportation and computer equipment under operating leases expiring during the next five years. The Company expects that most leases will be renewed or replaced by other leases in the normal course of business.

The Company has guaranteed the borrowings of certain independent franchisees under a franchise loan program with several banks. In the event these franchisees are unable to meet their debt service payments or otherwise experience an event of default, the Company would be unconditionally liable for the outstanding balance of the franchisee's debt obligations, which would be due in full within 90 days of the event of default. At September 30, 2007, the portion that the Company might be obligated to repay in the event franchisees defaulted was \$99.0 million. Of this amount, approximately \$74.0 million represents franchise borrowings outstanding under the franchise loan program and approximately \$25.0 million represents franchise borrowings under other debt facilities. However, due to franchisee borrowing limits, management believes any losses associated with any defaults would be mitigated through recovery of rental merchandise as well as the associated rental agreements and other assets. Since its inception in 1994, the Company has had no significant losses associated with the franchisee loan and guaranty program.

The Company has no long-term commitments to purchase merchandise. See Note F to the consolidated financial statements in the 2006 Annual Report on Form 10-K for further information.

### **Note G Related Party Transactions**

The Company leases certain properties under capital leases with certain related parties that are more fully described in Note D to the consolidated financial statements in the 2006 Annual Report on Form 10-K.



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As part of its extensive marketing program, the Company has sponsored professional driver Michael Waltrip's Aaron's Dream Machine in the NASCAR Busch Series. The sons of the president of the Company's sales and lease ownership division were paid by Mr. Waltrip's company as members of its team of drivers and raced Aaron's sponsored cars full time in the USAR Hooters Pro Cup Series in 2006. The amount paid in 2006 by the Company for the sponsorship of Michael Waltrip attributable to the USAR Hooters Pro Cup Series was \$983,000, adjusted by credits in the amount of \$434,000 for changes from the 2005 racing season. The Company's sponsorship cost for the drivers is expected to be less than \$750,000 in 2007. Motor sports sponsorships and promotions have been an integral part of the Company's marketing programs for a number of years.

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**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Shareholders

Aaron Rents, Inc.

We have reviewed the consolidated balance sheet of Aaron Rents, Inc. and subsidiaries as of September 30, 2007, and the related consolidated statements of income for the three-month and nine-month periods ended September 30, 2007 and 2006, and the consolidated statements of cash flows for the nine-month periods ended September 30, 2007 and 2006. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Aaron Rents, Inc. and subsidiaries as of December 31, 2006, and the related consolidated statements of income, shareholders' equity, and cash flows for the year then ended not presented herein, and in our report dated February 27, 2007, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2006, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

Atlanta, Georgia

November 5, 2007

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*Special Note Regarding Forward-Looking Information: Except for historical information contained herein, the matters set forth in this Form 10-Q are forward-looking statements. Forward-looking statements involve a number of risks and uncertainties that could cause actual results to differ materially from any such statements, including risks and uncertainties associated with our growth strategy, competition, trends in corporate spending, our franchise program, government regulation and the other risks and uncertainties discussed under Item 1A, Risk Factors, in the Company's Annual Report on Form 10-K for the Year Ended December 31, 2006, filed with the Securities and Exchange Commission, and in the Company's other public filings.*

The following discussion should be read in conjunction with the consolidated financial statements as of and for the three and nine months ended September 30, 2007, including the notes to those statements, appearing elsewhere in this report. We also suggest that this management's discussion and analysis be read in conjunction with the management's discussion and analysis and consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2006.

**Overview**

Aaron Rents, Inc. is a leading specialty retailer of consumer electronics, computers, residential and office furniture, household appliances and accessories. Our major operating divisions are the Aaron's Sales & Lease Ownership Division, the Aaron's Corporate Furnishings Division, and the MacTavish Furniture Industries Division, which manufactures and supplies nearly one-half of the furniture and related accessories rented and sold in our stores. Our sales and lease ownership division accounted for 91% and 90% respectively of our total revenues in both the third quarter and nine months of 2007 and 2006.

Aaron Rents has demonstrated strong revenue growth over the last three years. Total revenues have increased from \$946.5 million in 2004 to \$1.327 billion in 2006, representing a compound annual growth rate of 18.4%. Total revenues for the three months ended September 30, 2007, were \$359.4 million, an increase of \$41.7 million or 13.1%, over the comparable period in 2006. Total revenues for the nine months ended September 30, 2007 were \$1.106 billion, an increase of \$119.6 million or 12.1%, over the comparable period in 2006.

Most of our growth comes from the opening of new sales and lease ownership stores and increases in same store revenues from previously opened stores. We opened 78 company-operated sales and lease ownership stores in 2006. We estimate that we will add between 175 and 200 stores in 2007, a combination of company-operated and franchised stores. We opened 45 company-operated sales and lease ownership stores during the three months ended September 30, 2007. During the first nine months of 2007, we opened 76 new company-operated stores. We spend, on average, approximately \$600,000 in the first year of operation of a new store, which includes purchases of rental merchandise, investments in leasehold improvements and financing first year start-up costs. Our new sales and lease ownership stores typically achieve revenues of approximately \$1.1 million in their third year of operation. Our comparable stores opened more than three years normally achieve approximately \$1.4 million in unit revenues, which we believe represents a higher unit revenue volume than the typical rent-to-own store. Most of our stores are cash flow positive in the second year of operations following their opening.

We also use our franchise program to help us expand our sales and lease ownership concept more quickly and into more areas than we otherwise would by opening only company-operated stores. Our franchisees opened 75 stores in 2006. Our franchisees opened 11 stores during the three months ended September 30, 2007. During the first nine months of 2007 our franchisees opened 43 stores. We purchased 38 franchised stores during the first nine months of 2007. Franchise royalties and other related fees represent a growing source of high margin revenue for us, accounting for approximately \$33.6 million of revenues in 2006, up from \$25.3 million in 2004, representing a compounded annual growth rate of 15.4%. Total franchise royalties and fees revenues for the three months ended September 30, 2007 were \$8.9 million, an increase of \$.6 million or 6.7%, over the comparable period in 2006. Total franchise royalties and fees revenues for the nine months ended September 30, 2007 were \$28.4 million, an increase of \$3.6 million or 14.6%, over the comparable period in 2006.

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### **Key Components of Income**

In this management's discussion and analysis section, we review the Company's consolidated results including the five components of our revenues (rentals and fees, retail sales, non-retail sales, franchise royalties and fees, and other revenues), costs of sales and expenses (of which depreciation of rental merchandise is a significant part). We also review the results of our sales and lease ownership and corporate furnishings divisions.

*Revenues.* We separate our total revenues into five components: rentals and fees, retail sales, non-retail sales, franchise royalties and fees, and other revenues. Rentals and fees include all revenues derived from rental agreements from our sales and lease ownership and corporate furnishings stores, including agreements that result in our customers acquiring ownership at the end of the term. Retail sales represent sales of both new and rental return merchandise from our sales and lease ownership and corporate furnishings stores. Non-retail sales mainly represent merchandise sales to our sales and lease ownership division franchisees. Franchise royalties and fees represent fees from the sale of franchise rights and royalty payments from franchisees, as well as other related income from our franchised stores. Other revenues include, at times, income from gains on asset dispositions and other miscellaneous revenues.

*Cost of Sales.* We separate our cost of sales into two components: retail and non-retail. Retail cost of sales represents the original or depreciated cost of merchandise sold through our company-operated stores. Non-retail cost of sales primarily represents the cost of merchandise sold to our franchisees.

*Depreciation of Rental Merchandise.* Depreciation of rental merchandise reflects the expense associated with depreciating merchandise rented to customers and held for rent by our company-operated sales and lease ownership and corporate furnishings stores.

### **Critical Accounting Policies**

*Revenue Recognition.* Rental revenues are recognized in the month they are due on the accrual basis of accounting. For internal management reporting purposes, rental revenues from the sales and lease ownership division are recognized as revenue in the month the cash is collected. On a monthly basis, we record a deferral of revenue for rental payments received prior to the month due and an accrual for rental revenues due but not yet received, net of allowances. Our revenue recognition accounting policy matches the rental revenue with the corresponding costs, mainly depreciation, associated with the rental merchandise. As of September 30, 2007 and December 31, 2006, we had a revenue deferral representing cash collected in advance of being due or otherwise earned totaling \$24.1 million, for both periods, and accrued revenue receivable, net of allowance for doubtful accounts, based on historical collection rates of \$5.6 million and \$5.0 million, respectively. Revenues from the sale of merchandise to franchisees are recognized at the time of receipt by the franchisee, and revenues from such sales to other customers are recognized at the time of shipment.

*Rental Merchandise.* Our sales and lease ownership division depreciates merchandise over the agreement period, generally 12 to 24 months when rented, and 36 months when not rented, to 0% salvage value. Our corporate furnishings division depreciates merchandise over its estimated useful life, which ranges from nine months to 60 months, net of salvage value, which ranges from 0% to 60%. Sales and lease ownership merchandise is generally depreciated at a faster rate than our corporate furnishings merchandise.

Our policies require weekly rental merchandise counts by store managers and write-offs for unsalable, damaged, or missing merchandise inventories. Full physical inventories are generally taken at our fulfillment and manufacturing facilities on a quarterly basis with appropriate provisions made for missing, damaged and unsalable merchandise. In addition, we monitor rental merchandise levels and mix by division, store and fulfillment center, as well as the average age of merchandise on hand. If unsalable rental merchandise cannot be returned to vendors, its carrying value is adjusted to net realizable value or written off. All rental merchandise is available for rental and sale.

We record rental merchandise carrying value adjustments on the allowance method, which estimates the merchandise losses incurred but not yet identified by management as of the end of the accounting period.

*Leases and Closed Store Reserves.* The majority of our company-operated stores are operated from leased facilities under operating lease agreements. In general, lease terms range in length up to 15 years; however the majority of leases are for periods that do not exceed five years. Leasehold improvements related to these leases are generally

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amortized over periods that do not exceed the lesser of the lease term or five years. While a majority of our leases do not require escalating payments, for the leases which do contain such provisions we record the related lease expense on a straight-line basis over the lease term. We do not generally obtain significant amounts of lease incentives or allowances from landlords. Any incentive or allowance amounts we receive are recognized ratably over the lease term. From time to time, we close or consolidate stores. Our primary cost associated with closing or consolidating stores is the future lease payments and related commitments. We record an estimate of the future obligation related to closed or consolidated stores based upon the present value of the future lease payments and related commitments, net of estimated sublease income which we base upon historical experience. As of September 30, 2007 and December 31, 2006, our reserve for closed or consolidated stores was \$446,000 and \$693,000, respectively. If our estimates related to sublease income are not correct, our actual liability may be more or less than the liability recorded at September 30, 2007.

*Insurance Programs.* We maintain insurance contracts to fund workers compensation and group health insurance claims. Using actuarial analysis and projections, we estimate the liabilities associated with open and incurred but not reported workers compensation claims. This analysis is based upon an assessment of the likely outcome or historical experience, net of any stop loss or other supplementary coverages. We also calculate the projected outstanding plan liability for our group health insurance program. At September 30, 2007 and December 30, 2006, we were in a net prepaid position of \$3.6 million and \$656,000 respectively, related to our workers compensation and group health insurance.

If we resolve existing workers compensation claims for amounts that are in excess of our current estimates and within policy stop loss limits, we will be required to pay additional amounts beyond those accrued at September 30, 2007. Additionally, if the actual group health insurance liability exceeds our projections and within policy stop loss limits, we will be required to pay additional amounts beyond those accrued at September 30, 2007.

The assumptions and conditions described above reflect management's best assumptions and estimates, but these items involve inherent uncertainties as described above, which may or may not be controllable by management. As a result, the accounting for such items could result in different amounts if management used different assumptions or if different conditions occur in future periods.

*Same Store Revenues.* We refer to changes in same store revenues as a key performance indicator. For the three months ended September 30, 2007, we calculated this amount by comparing revenues for the three months ended September 30, 2007 to revenues for the comparable period in 2006 for all stores open for the entire 15-month period ended September 30, 2007, excluding stores that received rental agreements from other acquired, closed, or merged stores. For the nine months ended September 30, 2007, we calculated this amount by comparing revenues for the nine months ended September 30, 2007 to revenues for the comparable period in 2006 for all stores open for the entire 24-month period ended September 30, 2007, excluding stores that received rental agreements from other acquired, closed, or merged stores.

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**Table of Contents****Results of Operations****Three months ended September 30, 2007 compared with three months ended September 30, 2006**

The following table shows key selected financial data for the three month periods ended September 30, 2007 and 2006, and the changes in dollars and as a percentage to 2007 from 2006:

| (In Thousands)                      | Three<br>Months<br>Ended<br>September<br>30, 2007 | Three Months<br>Ended<br>September 30,<br>2006 | Dollar<br>Increase/<br>(Decrease) to<br>2007 from<br>2006 | % Increase/<br>(Decrease) to<br>2007 from<br>2006 |
|-------------------------------------|---------------------------------------------------|------------------------------------------------|-----------------------------------------------------------|---------------------------------------------------|
| <b>REVENUES:</b>                    |                                                   |                                                |                                                           |                                                   |
| Rentals and Fees                    | \$278,104                                         | \$ 243,649                                     | \$ 34,455                                                 | 14.1%                                             |
| Retail Sales                        | 12,808                                            | 14,330                                         | (1,522)                                                   | (10.6)                                            |
| Non-Retail Sales                    | 58,140                                            | 49,429                                         | 8,711                                                     | 17.6                                              |
| Franchise Royalties and Fees        | 8,881                                             | 8,322                                          | 559                                                       | 6.7                                               |
| Other                               | 1,448                                             | 1,979                                          | (531)                                                     | (26.8)                                            |
|                                     | 359,381                                           | 317,709                                        | 41,672                                                    | 13.1                                              |
| <b>COSTS AND EXPENSES:</b>          |                                                   |                                                |                                                           |                                                   |
| Retail Cost of Sales                | 8,389                                             | 9,553                                          | (1,164)                                                   | (12.2)                                            |
| Non-Retail Cost of Sales            | 53,095                                            | 45,210                                         | 7,885                                                     | 17.4                                              |
| Operating Expenses                  | 169,105                                           | 143,601                                        | 25,504                                                    | 17.8                                              |
| Depreciation of Rental Merchandise  | 101,299                                           | 89,806                                         | 11,493                                                    | 12.8                                              |
| Interest                            | 2,180                                             | 1,914                                          | 266                                                       | 13.9                                              |
|                                     | 334,068                                           | 290,084                                        | 43,984                                                    | 15.2                                              |
| <b>EARNINGS BEFORE INCOME TAXES</b> |                                                   |                                                |                                                           |                                                   |
| <b>TAXES</b>                        | 25,313                                            | 27,625                                         | (2,312)                                                   | (8.4)                                             |
| <b>INCOME TAXES</b>                 | 9,394                                             | 10,242                                         | (848)                                                     | (8.3)                                             |
| <b>NET EARNINGS</b>                 | \$ 15,919                                         | \$ 17,383                                      | \$ (1,464)                                                | (8.4)%                                            |

*Revenues.* The 13.1% increase in total revenues, to \$359.4 million for the three months ended September 30, 2007 from \$317.7 million in the comparable period in 2006, was due mainly to a \$34.5 million, or 14.1%, increase in rentals and fees revenues, plus an \$8.7 million increase in non-retail sales. The increase in rentals and fees revenues was primarily attributable to a \$33.3 million increase from our sales and lease ownership division, which had a 4.0% increase in same store revenues during the third quarter of 2007 and added 150 company-operated stores, an increase of 18.7%, since the end of September 30, 2006.

Revenues from retail sales decreased 10.6% to \$12.8 million for the three months ended September 30, 2007 from \$14.3 million for the comparable period in 2006 primarily related to a decrease in such revenues in our sales and lease ownership division, which reflects a decreased focus on retail sales in certain stores and the impact of the introduction of an alternative shorter-term lease, which we believe replaced many retail sales. Additionally, the decline in retail sales was driven by a strategic decision to increase retail sales prices effective in the fourth quarter of 2006. Retail

sales represent sales of both new and returned rental merchandise.

The 17.6% increase in non-retail sales (which mainly represents merchandise sold to our franchisees) to \$58.1 million for the three months of September 30, 2007 from \$49.4 million for the comparable period in 2006, was due to the growth of our franchise operations and our distribution network. The total number of franchised sales and lease ownership stores at September 30, 2007 was 446, reflecting a net addition of 35 stores since September 30, 2006.

The 6.7% increase in franchise royalties and fees, to \$8.9 million for the three months ended September 30, 2007 from \$8.3 million for the comparable period in 2006, primarily reflects an increase in royalty income from franchisees, increasing 13.3% to \$7.1 million for the three months ended September 30, 2007 compared to \$6.2 million for the three months ended September 30, 2006, due to the growth of our franchise operations and our distribution network. The increase in royalty income is offset by a decrease in franchise fees during the same three month period. Eleven franchised stores were opened by the company during the third quarter of 2007 versus sixteen

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franchised stores opened by the company during the third quarter of 2006. Franchise fees for the three months ended September 30, 2007 were \$390,000 compared to \$717,000 for the same period in 2006.

Other revenues decreased to \$1.4 million for the three months ended September 30, 2007 from \$2.0 million for the comparable period in 2006 primarily due to a decline in investment and interest income during the period.

With respect to our major operating units, revenues for our sales and lease ownership division increased 14.6%, to \$328.1 million for the three months ended September 30, 2007 from \$286.2 million for the comparable period in 2006. This increase was attributable to the sales and lease ownership division adding 150 stores since September 30, 2006 combined with same store revenue growth of 4.0% for the three months ended September 30, 2007. The 2.3% decrease in corporate furnishings division revenues, to \$29.7 million for the three months ended September 30, 2007 from \$30.4 million for the comparable period in 2006, is primarily the result of increased business during 2006 related to the hurricanes in the Gulf Coast region in 2005.

*Cost of Sales.* Cost of sales from retail sales decreased 12.2% to \$8.4 million for the three months ended September 30, 2007 compared to \$9.6 million for the comparable period in 2006, and as a percentage of retail sales decreased slightly to 65.5% from 66.7% in 2007 and 2006, respectively. Cost of sales from non-retail sales increased 17.4%, to \$53.1 million for the three months ended September 30, 2007 from \$45.2 million for the comparable period in 2006, and as a percentage of non-retail sales, decreased to 91.3% from 91.5%. The increased margins on non-retail sales were primarily the result of lower product cost.

*Expenses.* Operating expenses for the three months ended September 30, 2007 increased \$25.5 million to \$169.1 million from \$143.6 million for the comparable period in 2006, a 17.8% increase, reflecting an increase in costs associated with opening new stores, advertising and merchandise write-offs. As a percentage of total revenues, operating expenses were 47.1% for the three months ended September 30, 2007 and 45.2% for the comparable period in 2006.

Depreciation of rental merchandise increased \$11.5 million to \$101.3 million for the three months ended September 30, 2007 from \$89.8 million during the comparable period in 2006, a 12.8% increase. As a percentage of total rentals and fees, depreciation of rental merchandise decreased slightly to 36.4% from 36.9% from quarter to quarter.

Interest expense increased to \$2.2 million for the three months ended September 30, 2007 compared with \$1.9 million for the comparable period in 2006, a 13.9% increase. The increase in interest expense was primarily due to higher debt levels during the third quarter of 2007 compared to the same period a year ago.

Income tax expense decreased \$.8 million to \$9.4 million for the three months ended September 30, 2007 compared with \$10.2 million for the comparable period in 2006, representing an 8.3% decrease due to lower pre-tax earnings.

Aaron Rents' effective tax rate was 37.1% in both 2007 and 2006.

*Net Earnings.* Net earnings decreased \$1.5 million to \$15.9 million for the three months ended September 30, 2007 compared with \$17.4 million for the comparable period in 2006, representing a 8.4% decrease. As a percentage of total revenues, net earnings were 4.4% for the three months ended September 30, 2007 and 5.5% for the three months ended September 30, 2006.

### **Nine months ended September 30, 2007 compared with nine months ended September 30, 2006**

The following table shows key selected financial data for the nine month periods ended September 30, 2007 and 2006, and the changes in dollars and as a percentage to 2007 from 2006:

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| <b>(In Thousands)</b>               | <b>Nine Months<br/>Ended<br/>September 30,<br/>2007</b> | <b>Nine Months<br/>Ended<br/>September 30,<br/>2006</b> | <b>Dollar<br/>Increase/<br/>(Decrease) to<br/>2007 from<br/>2006</b> | <b>% Increase/<br/>(Decrease)<br/>to<br/>2007 from<br/>2006</b> |
|-------------------------------------|---------------------------------------------------------|---------------------------------------------------------|----------------------------------------------------------------------|-----------------------------------------------------------------|
| <b>REVENUES:</b>                    |                                                         |                                                         |                                                                      |                                                                 |
| Rentals and Fees                    | \$ 841,828                                              | \$ 743,689                                              | \$ 98,139                                                            | 13.2%                                                           |
| Retail Sales                        | 40,948                                                  | 49,432                                                  | (8,484)                                                              | (17.2)                                                          |
| Non-Retail Sales                    | 185,047                                                 | 159,813                                                 | 25,234                                                               | 15.8                                                            |
| Franchise Royalties and Fees        | 28,397                                                  | 24,770                                                  | 3,627                                                                | 14.6                                                            |
| Other                               | 10,080                                                  | 9,019                                                   | 1,061                                                                | 11.8                                                            |
|                                     | 1,106,300                                               | 986,723                                                 | 119,577                                                              | 12.1                                                            |
| <b>COSTS AND EXPENSES:</b>          |                                                         |                                                         |                                                                      |                                                                 |
| Retail Cost of Sales                | 27,180                                                  | 32,826                                                  | (5,646)                                                              | (17.2)                                                          |
| Non-Retail Cost of Sales            | 169,355                                                 | 148,308                                                 | 21,047                                                               | 14.2                                                            |
| Operating Expenses                  | 494,519                                                 | 430,375                                                 | 64,144                                                               | 14.9                                                            |
| Depreciation of Rental Merchandise  | 305,413                                                 | 273,408                                                 | 32,005                                                               | 11.7                                                            |
| Interest                            | 5,965                                                   | 7,860                                                   | (1,895)                                                              | (24.1)                                                          |
|                                     | 1,002,432                                               | 892,777                                                 | 109,655                                                              | 12.3                                                            |
| <b>EARNINGS BEFORE INCOME TAXES</b> |                                                         |                                                         |                                                                      |                                                                 |
| <b>TAXES</b>                        | 103,868                                                 | 93,946                                                  | 9,922                                                                | 10.6                                                            |
| <b>INCOME TAXES</b>                 | 39,085                                                  | 34,352                                                  | 4,733                                                                | 13.8                                                            |
| <b>NET EARNINGS</b>                 | \$ 64,783                                               | \$ 59,594                                               | \$ 5,189                                                             | 8.7%                                                            |

*Revenues.* The 12.1% increase in total revenues, to \$1.106 billion for the nine months ended September 30, 2007 from \$986.7 million in the comparable period in 2006, was due mainly to a \$98.1 million, or 13.2%, increase in rentals and fees revenues, plus a \$25.2 million increase in non-retail sales. The increase in rentals and fees revenues was primarily attributable to a \$96.2 million increase in revenues from our sales and lease ownership division, which had a 2.1% increase in same store revenues during the 24 month period ended September 30, 2007 and added 150 company-operated stores since the end of September 30, 2006. Included in other revenues in 2007 was a \$4.9 million gain from the sale of a parking deck at the Company's corporate headquarters. Included in other revenues in 2006 was a \$4.4 million gain from the sale of the assets of our 12 stores located in Puerto Rico.

Revenues from retail sales decreased 17.2% to \$40.9 million for the nine months ended September 30, 2007 from \$49.4 million for the comparable period in 2006 primarily related to a decrease in such revenues in our sales and lease ownership division, which reflects a decreased focus on retail sales in certain stores and the impact of the introduction of an alternative shorter-term lease, which we believe replaced many retail sales. Additionally, the decline in retail sales was driven by a strategic decision to increase retail sales prices effective in the fourth quarter of 2006. Retail sales represent sales of both new and returned rental merchandise.

The 15.8% increase in non-retail sales (which mainly represents merchandise sold to our franchisees) to \$185.0 million for the nine months of September 30, 2007 from \$159.8 million for the comparable period in 2006, was due to the growth of our franchise operations and our distribution network. The total number of franchised sales

and lease ownership stores at September 30, 2007 was 446, reflecting a net addition of 35 stores since September 30, 2006.

The 14.6% increase in franchise royalties and fees, to \$28.4 million for the nine months ended September 30, 2007 from \$24.8 million for the comparable period in 2006, primarily reflects an increase in royalty income from franchisees, increasing 15.5% to \$22.0 million for the nine months ended September 30, 2007 compared to \$19.1 million for the nine months ended September 30, 2006, due to the growth and maturation of our franchise operations and our distribution network.

The 11.8% increase in other revenues, to \$10.1 million for the nine months ended September 30, 2007 from \$9.0 million for the comparable period in 2006, is attributable to a \$4.9 million gain from the sale of a parking deck at the Company's corporate headquarters, offset by a \$4.4 million gain from the sale of the assets of our 12 stores located in Puerto Rico in 2006, with the remainder contributed by several miscellaneous other revenue sources.

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With respect to our major operating units, revenues for our sales and lease ownership division increased 13.1%, to \$1.007 billion for the nine months ended September 30, 2007 from \$890.7 million for the comparable period in 2006. This increase was attributable to the sales and lease ownership division adding 150 stores since September 30, 2006 combined with same store revenue growth of 2.1% for stores open over two years at the end of September 30, 2007. Corporate furnishings division revenues decreased to \$91.5 million for the nine months ended September 30, 2007 from \$93.8 million for the comparable period in 2006. The 2.4% decrease in corporate furnishings division revenues is primarily the result of increased business during 2006 related to the hurricanes in the Gulf Coast region in 2005.

*Cost of Sales.* Cost of sales from retail sales decreased 17.2% to \$27.2 million for the nine months ended September 30, 2007 compared to \$32.8 million for the comparable period in 2006, and as a percentage of retail sales remained at 66.4% for both 2007 and 2006. Cost of sales from non-retail sales increased 14.2%, to \$169.4 million for the nine months ended September 30, 2007 from \$148.3 million for the comparable period in 2006, and as a percentage of non-retail sales, decreased to 91.5% from 92.8%. The increased margins on non-retail sales were primarily the result of lower product cost.

*Expenses.* Operating expenses for the nine months ended September 30, 2007 increased \$64.1 million to \$494.5 million from \$430.4 million for the comparable period in 2006, a 14.9% increase, reflecting an increase in costs associated with opening new stores, advertising and merchandise write-offs. As a percentage of total revenues, operating expenses were 44.7% for the nine months ended September 30, 2007 and 43.6% for the comparable period in 2006.

Depreciation of rental merchandise increased \$32.0 million to \$305.4 million for the nine months ended September 30, 2007 from \$273.4 million during the comparable period in 2006, an 11.7% increase. As a percentage of total rentals and fees, depreciation of rental merchandise decreased slightly to 36.3% from 36.8% from period to period. The increased rental margins were primarily the result of lower product cost and a change in product mix. Interest expense decreased to \$6.0 million for the nine months ended September 30, 2007 compared with \$7.9 million for the comparable period in 2006, a 24.1% decrease. The decrease in interest expense was primarily due to lower debt levels during 2007 compared to a year ago.

Income tax expense increased \$4.7 million to \$39.1 million for the nine months ended September 30, 2007 compared with \$34.4 million for the comparable period in 2006, representing a 13.8% increase. Aaron Rents' effective tax rate was 37.6% in 2007 and 36.6% in 2006. In 2006 the effective tax rate was lower primarily because of amendments to Texas state tax law which allowed the company to recognize an \$869,000 income tax benefit.

*Net Earnings.* Net earnings increased \$5.2 million to \$64.8 million for the nine months ended September 30, 2007 compared with \$59.6 million for the comparable period in 2006, representing an 8.7% increase. As a percentage of total revenues, net earnings were 5.9% for the nine months ended September 30, 2007 and 6.0% for the nine months ended September 30, 2006.

### **Balance Sheet**

*Cash.* Our cash balance increased to \$9.7 million at September 30, 2007 from \$8.8 million at December 31, 2006. Fluctuations in our cash balances are the result of timing differences between when our stores deposit cash and when that cash is available for application against borrowings outstanding under our revolving credit facility. For additional information refer to the Liquidity and Capital Resources section below.

*Rental Merchandise.* The increase of \$2.1 million in rental merchandise, net of accumulated depreciation, to \$614.2 million at September 30, 2007 from \$612.1 million at December 31, 2006, is primarily the result of a net increase of 111 company-operated stores since December 31, 2006, and the continued revenue growth of existing company-operated stores, offset by higher inventory levels at December 30, 2006, in anticipation of store growth.

*Goodwill and Other Intangibles.* The \$24.8 million increase in goodwill and other intangibles, to \$140.2 million at September 30, 2007 from \$115.4 million at December 31, 2006, is the result of a series of acquisitions of sales and lease ownership businesses, net of amortization of certain finite-life intangible assets. The aggregate purchase price for these asset acquisitions during the nine months ended September 30, 2007 totaled \$42.6 million, with the principal tangible assets acquired consisting of rental merchandise and certain fixtures and equipment.

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*Prepaid Expenses and Other Assets.* Prepaid expenses and other assets increased \$10.8 million to \$40.3 million at September 30, 2007 from \$29.4 million at December 31, 2006 in part as a result of an increase in prepaid advertising in the sales and lease ownership division as well as an increase in prepaid insurance.

*Accounts Payable and Accrued Expenses.* The increase of \$14.4 million in accounts payable and accrued expenses, to \$135.5 million at September 30, 2007 from \$121.0 million at December 31, 2006, is the result of increased merchandise purchases to meet seasonal needs associated with the holiday season and net company-operated store growth of 111 stores via new openings and acquisitions during the year.

*Deferred Income Taxes Payable.* The decrease of \$2.4 million in deferred income taxes payable to \$91.3 million at September 30, 2007 from \$93.7 million at December 31, 2006 is primarily due to the reclassification between current and deferred taxes as a result of the annual return to provision reconciliation for the 2006 tax year.

*Credit Facilities and Senior Notes.* The \$22.5 million increase in the amounts we owe under our credit facilities and senior notes to \$152.5 million at September 30, 2007 from \$130.0 million at December 31, 2006, reflects net borrowings under our revolving credit facility during the first nine months of 2007 with cash generated from operations offset by net company-operated store growth of 111 stores via new store construction and acquisitions during the year.

## **Liquidity and Capital Resources**

### *General*

Cash flows from operations for the nine months ended September 30, 2007 and 2006 were \$96.0 million and \$98.3 million, respectively. Purchases of sales and lease ownership stores had a positive impact on operating cash flows in each period presented. The positive impact on operating cash flows from purchasing stores occurs as the result of rental merchandise, other assets and intangibles acquired in these purchases being treated as an investing cash outflow. As such, the operating cash flows attributable to the newly purchased stores usually has an initial positive effect on operating cash flows that may not be indicative of the extent of their contributions in future periods. Our cash flows include profits on the sale of rental return merchandise. Our primary capital requirements consist of buying rental merchandise for both sales and lease ownership and corporate furnishings stores. As Aaron Rents continues to grow, the need for additional rental merchandise will continue to be our major capital requirement. Other capital requirements include purchases of property, plant and equipment and expenditures for acquisitions. These capital requirements historically have been financed through:

cash flow from operations;

bank credit;

trade credit with vendors;

proceeds from the sale of rental return merchandise;

private debt offerings; and

stock offerings.

In May 2006, we completed an underwritten public offering of 3.45 million newly-issued shares of our common stock for net proceeds, after the underwriting discount and expenses, of approximately \$84.0 million. We used the proceeds to repay borrowings under our revolving credit facility. The Company's Chairman, Chief Executive Officer and controlling shareholder sold an additional 1.15 million shares in the offering.

At September 30, 2007, \$47.6 million was outstanding under our revolving credit agreement. The credit facilities balance increased by \$22.5 million in the first nine months of 2007 primarily as a result of expenditures associated with our net company-operated store growth of 111 stores during the year. We renegotiated our revolving credit agreement on February 27, 2006, extending the life of the agreement until May 28, 2008, and increasing the total available credit to \$140.0 million. We have \$20.0 million currently outstanding in aggregate principal amount of 6.88% senior unsecured notes due August 2009, the first principal repayments which were due and paid in 2005 in the

aggregate amount of \$10.0 million, with annual \$10.0 million repayments due until maturity. Additionally, we have \$60.0 million currently outstanding in aggregate principal amount of 5.03% senior unsecured notes due July 2012, principal repayments which are first required in 2008. See Note D to the consolidated financial statements appearing in the Company's 2006 Annual Report on Form 10-K for further information.

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Our revolving credit agreement, senior unsecured notes, and franchisee loan program discussed below, contain financial covenants which, among other things, forbid us from exceeding certain debt to equity levels and require us to maintain minimum fixed charge coverage ratios. If we fail to comply with these covenants, we will be in default under these agreements, and all amounts would become due immediately. We were in compliance with all of these covenants at September 30, 2007.

We purchase our common shares in the market from time to time as authorized by our board of directors. As of September 30, 2007, Aaron Rents was authorized by its board of directors to purchase up to an additional 2,670,502 common shares under previously approved resolutions. No shares have been acquired in the nine months ended September 30, 2007.

We have a consistent history of paying dividends, having paid dividends for 20 consecutive years. Our board of directors increased the dividend 7.1% for the fourth quarter of 2006 on November 7, 2006 to \$.015 per share from the previous quarterly dividend of \$.014 per share. The 2006 fourth quarter dividend was paid in January 2007, the 2007 first quarter dividend was paid in April 2007, and the 2007 second quarter dividend was paid in July 2007. Total cash outlay for dividends was \$2.4 million and \$2.2 million for the nine months ended September 30, 2007 and 2006, respectively. Subject to sufficient operating profits, any future capital needs and other contingencies, we currently expect to continue our policy of paying dividends.

If we achieve our expected level of growth in our operations, we anticipate we can supplement our expected cash flows from operations, existing credit facilities, vendor credit, and proceeds from the sale of rental return merchandise by expanding our existing credit facilities, by securing additional debt financing, or by seeking other sources of capital to ensure we will be able to fund our capital and liquidity needs for at least the next 24 months. We believe we can secure these additional sources of liquidity in the ordinary course of business.

### **Commitments**

*Income Taxes.* During the nine months ended September 30, 2007, we made \$40.1 million in income tax payments. Within the next three months, we anticipate that we will make cash payments for income taxes of approximately \$10.0 million. The Company has benefited in the past from the additional first-year or bonus depreciation allowance under U.S. federal income tax law, which generally allowed us to accelerate the depreciation on rental merchandise we acquired after September 10, 2001 and placed in service prior to January 1, 2005. The Company is currently receiving benefits from bonus depreciation related to its operations in the Gulf Opportunities Zone. We anticipate having to make increased future tax payments on our income as a result of expected profitability and the reversal of the benefits associated with accelerated depreciation deductions that were taken in prior periods.

*Leases.* We lease warehouse and retail store space for substantially all of our operations under operating leases expiring at various times through 2024. Most of the leases contain renewal options for additional periods ranging from one to 15 years or provide for options to purchase the related property at predetermined purchase prices that do not represent bargain purchase options. We also lease transportation and computer equipment under operating leases expiring during the next five years. We expect that most leases will be renewed or replaced by other leases in the normal course of business. Approximate future minimum rental payments required under operating leases that have initial or remaining non-cancelable terms in excess of one year as of September 30, 2007 are shown in the below table under Contractual Obligations and Commitments.

We have 22 capital leases, 21 of which are with a limited liability company ( LLC ) whose managers and owners are 14 Aaron Rents executive officers and its controlling shareholder, with no individual, including the controlling shareholder, owning more than 10.53% of the LLC. Eleven of these related party leases relate to properties purchased from Aaron Rents in October and November of 2004 by the LLC for a total purchase price of \$6.8 million. The LLC is leasing back these properties to Aaron Rents for a 15-year term, with a five-year renewal at Aaron Rents option, at an aggregate annual rental of \$883,000. Another ten of these related party leases relate to properties purchased from Aaron Rents in December 2002 by the LLC for a total purchase price of approximately \$5.0 million. The LLC is leasing back these properties to Aaron Rents for a 15-year term at an aggregate annual rental of \$572,000.

We do not currently plan to enter into any similar related party lease transactions in the future. See Note D to the Consolidated Financial Statements in the 2006 Annual Report on Form 10-K.



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We finance a portion of our store expansion through sale-leaseback transactions. The properties are sold at net book value and the resulting leases qualify and are accounted for as operating leases. We do not have any retained or contingent interests in the stores nor do we provide any guarantees, other than a corporate level guarantee of lease payments, in connection with the sale-leasebacks. The operating leases that resulted from these transactions are included in the table below.

*Franchisee Loan Guaranty.* We have guaranteed the borrowings of certain independent franchisees under a franchise loan program with several banks and we also guarantee franchisee borrowings under certain other debt facilities. On February 27, 2007, we amended the franchise loan facility and guaranty to increase the maximum commitment amount from \$115.0 million to \$125.0 million. At September 30, 2007, the portion that the Company might be obligated to repay in the event franchisees defaulted was \$99.0 million. Of this amount, approximately \$74.0 million represents franchisee borrowings outstanding under the franchisee loan program and approximately \$25.0 million represents franchisee borrowings that we guarantee under other debt facilities. However, due to franchisee borrowing limits, we believe any losses associated with any defaults would be mitigated through recovery of rental merchandise and other assets. Since its inception in 1994, we have had no significant losses associated with the franchisee loan and guaranty program. On May 29, 2007 we entered into a franchise loan facility and guaranty with a bank to guarantee the borrowings of certain independent RIMCO franchisees. The maximum commitment amount under this program is \$3.5 million. We believe the likelihood of any significant amounts being funded in connection with these commitments to be remote.

*Contractual Obligations and Commitments.* The following table shows the Company's approximate contractual obligations, including interest, and commitments to make future payments as of September 30, 2007:

| (In Thousands)                                 | Total      | Period Less<br>Than 1<br>Year | Period<br>2-3<br>Years | Period<br>4-5<br>Years | Period<br>Over<br>5 Years |
|------------------------------------------------|------------|-------------------------------|------------------------|------------------------|---------------------------|
| Credit Facilities,<br>Excluding Capital Leases | \$ 133,105 | \$ 71,788                     | \$ 34,012              | \$ 24,004              | \$ 3,301                  |
| Capital Leases                                 | 19,386     | 1,069                         | 2,387                  | 2,799                  | 13,131                    |
| Operating Leases                               | 311,535    | 76,697                        | 102,039                | 48,975                 | 83,824                    |
| Total Contractual Cash Obligations             | \$ 464,026 | \$ 149,554                    | \$ 138,438             | \$ 75,778              | \$ 100,256                |

The following table shows the Company's approximate commercial commitments as of September 30, 2007:

| (In Thousands)                       | Total<br>Amounts<br>Committed | Period Less<br>Than 1<br>Year | Period<br>1-3<br>Years | Period<br>4-5<br>Years | Period<br>Over<br>5 Years |
|--------------------------------------|-------------------------------|-------------------------------|------------------------|------------------------|---------------------------|
| Guaranteed Borrowings of Franchisees | \$99,008                      | \$99,008                      | \$                     | \$                     | \$                        |

**Market Risk**

Occasionally, we manage our exposure to changes in short-term interest rates, particularly to reduce the impact on our floating-rate borrowings, by entering into interest rate swap agreements.

At September 30, 2007, we did not have any swap agreements.

We do not use any market risk sensitive instruments to hedge commodity, foreign currency or risks other than interest rate risk, and hold no market risk sensitive instruments for trading or speculative purposes.

**New Accounting Pronouncements**

See Note E to the Consolidated Financial Statements contained in Part I, Item 1 of this Quarterly Report on Form 10-Q.



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**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The information called for by this item is provided under Item 7A in the Company's Annual Report on Form 10-K for the year ended December 31, 2006, and Part I, Item 2 of this Quarterly Report above.

**ITEM 4. CONTROLS AND PROCEDURES**

**Disclosure Controls and Procedures.**

An evaluation of the Company's disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, was carried out by management, with the participation of the Chief Executive Officer (CEO) and Chief Financial Officer (CFO), as of the end of the period covered by this Quarterly Report on Form 10-Q. No system of controls, no matter how well designed and operated, can provide absolute assurance that the objectives of the system of controls are met, and no evaluation of controls can provide absolute assurance that the system of controls has operated effectively in all cases. Our disclosure controls and procedures, however, are designed to provide reasonable assurance that the objectives of disclosure controls and procedures are met.

Based on management's evaluation, the CEO and CFO concluded that the Company's disclosure controls and procedures were effective as of the date of the evaluation to provide reasonable assurance that the objectives of disclosure controls and procedures are met.

**Internal Control Over Financial Reporting.**

There were no changes in Aaron Rents' internal control over financial reporting, as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, during the Company's third quarter of 2007 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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**PART II OTHER INFORMATION**

**ITEM 1A. RISK FACTORS**

The Company does not have any updates to its risk factors disclosure from that previously reported in its Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

**ITEM 6. EXHIBITS**

The following exhibits are furnished herewith:

- 15 Letter Re: Unaudited Interim Financial Information.
  - 31(a) Certification of Chief Executive Officer, pursuant to Rules 13a-14(a)/15d-14(a).
  - 31(b) Certification of Chief Financial Officer, pursuant to Rules 13a-14(a)/15d-14(a).
  - 32(a) Certification of Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
  - 32(b) Certification of Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

AARON RENTS, INC.  
(Registrant)

Date November 7, 2007

By: /s/ Gilbert L. Danielson  
Gilbert L. Danielson  
Executive Vice President,  
Chief Financial Officer

Date November 7, 2007

/s/ Robert P. Sinclair, Jr.  
Robert P. Sinclair, Jr.  
Vice President,  
Corporate Controller