

# AARON'S<sup>®</sup>

brings it home.



*Aaron's, Inc.*

Annual Report 2011

## ABOUT US



Aaron's, Inc. serves consumers through the sale and lease ownership and specialty retailing of residential furniture, consumer electronics, home appliances and accessories in over 1,950 Company-operated and franchised stores in the United States and Canada. Aaron's is the industry leader in serving the moderate-income consumer and offering affordable payment plans, quality merchandise and superior service. The Company's strategic focus is on growing the sales and lease ownership business through the addition of new Company-operated stores by both internal expansion and acquisitions, as well as through its successful and expanding franchise program.

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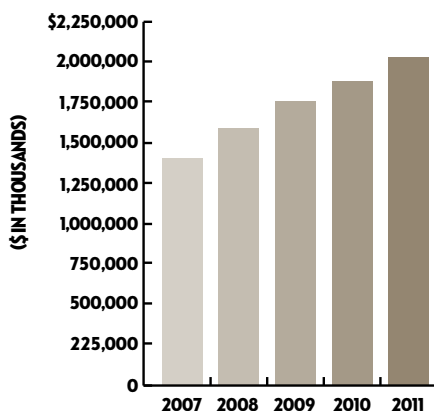
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# FINANCIAL HIGHLIGHTS

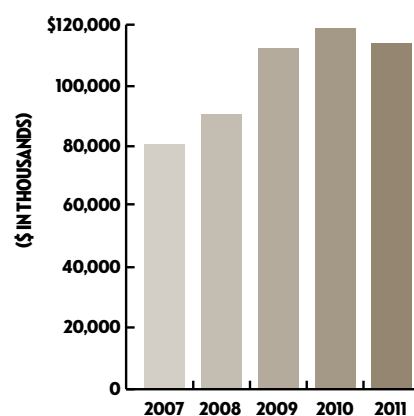
(Dollar Amounts in Thousands, Except Per Share)	Year Ended December 31, 2011	Year Ended December 31, 2010	Percentage Change
<b>OPERATING RESULTS</b>			
Revenues	\$2,024,049	\$1,876,847	7.8%
Earnings Before Taxes	183,377	190,786	(3.9)
Net Earnings	113,767	118,376	(3.9)
Earnings Per Share	1.46	1.46	(0.0)
Earnings Per Share Assuming Dilution	1.43	1.44	(0.7)
<b>FINANCIAL POSITION</b>			
Total Assets	\$1,735,149	\$1,502,072	15.5%
Lease Merchandise, Net	862,276	814,484	5.9
Credit Facilities	153,789	41,790	268.0
Shareholders' Equity	976,554	979,417	(0.3)
Book Value Per Share	12.91	12.23	5.6
Debt to Capitalization	13.6%	4.1%	
Pretax Profit Margin	9.1	10.2	
Net Profit Margin	5.6	6.3	
Return on Average Equity	11.6	12.7	
<b>STORES OPEN AT YEAR-END</b>			
Aaron's Sales & Lease Ownership	1,160	1,146	1.2%
Aaron's Sales & Lease Ownership Franchised*	713	664	7.4
HomeSmart	71	3	2,266.7
Aaron's Office Furniture	1	1	0.0
Total Stores	1,945	1,814	7.2%

\* Aaron's Sales & Lease Ownership franchised stores are not owned or operated by Aaron's, Inc.

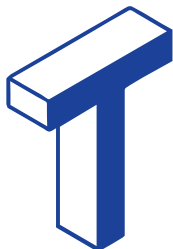
Revenues By Year



Net Earnings By Year



# TO OUR SHAREHOLDERS



The strength of the Aaron's business model was evident in our operating results for 2011 and remains the foundation for continued growth. We achieved record revenues during the year and our earnings, excluding certain unusual items, were also at a record level.

The economic environment in which we operate continues to be challenging with high rates of unemployment in most of our markets, and our typical customer remains credit-constrained. We believe Aaron's is well-positioned for this environment. We offer consumers flexible lease terms, affordable pricing, a broad range of products and the ability to terminate a lease and return a product at any time. We are proud of our business model, our associates, our corporate values and the 2011 operating results.

For the second year in a row, the Company achieved more than 10 percent growth in the number of our customers. Customer count on a same store basis for Company-operated stores and franchised stores was up 6.4% and 4.6%, respectively, over a year ago. At the end of 2011, we had over one million corporate and over 550,000 franchise customers. Store traffic has been strong, and our "Credit is Hard, Aaron's is Easy!" tag line has been an effective, distinctive message to consumers in all parts of the country.

Revenues for 2011 crossed the \$2 billion mark, an 8% increase compared to 2010. In addition, our franchisees also reported an 8% increase in revenues to over \$900 million, although those revenues are not revenues of Aaron's, Inc.

Net earnings for the year were \$113.8 million compared to the \$118.4 million earned in 2010. Results for 2011, however, reflected certain unusual items, including a \$36.5 million charge related to a lawsuit verdict. Fully diluted earnings per share for the year were \$1.43 compared to \$1.44 in 2010.

In 2011, the Company opened 57 new Aaron's Sales & Lease Ownership stores and our franchisees opened 55 new stores. We also added 68 HomeSmart stores during the year. At the end of 2011, we had 1,945 stores open — a combination

of Company-operated and franchised stores. Our 2,000th store will open in 2012 and there are many exciting promotions planned for this significant milestone.

In 2011, we expanded our new HomeSmart concept which is based on a weekly payment model. As a result of several opportunistic acquisitions, HomeSmart has grown rapidly and by the end of the year we had 71 stores in operation. These stores are in a pilot phase but early results are encouraging and we have experienced minimal cannibalization from neighboring Aaron's Sales & Lease Ownership stores. Our focus in 2012 is refining HomeSmart and evaluating the stores' financial performance and returns. We are optimistic and hopeful that HomeSmart will prove to be a successful growth opportunity.

Our Woodhaven Furniture Industries division provides the majority of our upholstered and bedding products. Woodhaven had a record year in 2011, manufacturing close to \$90 million, at cost, of furniture and bedding for our stores.

Aaron's launched its first national advertising campaign in 2011 and branding initiatives are a key focus for 2012. In addition to brand development, we are working to better educate the consumer on the Aaron's advantage and our distinctive placement within the home furnishings industry.

In October, the Company purchased an 11.5% interest in Perfect Home Holdings Ltd., a privately-held rent-to-own company which provides basic home furnishings through 45 stores in the United Kingdom. Perfect Home is expected to double its store base over the next several years and this investment provides another avenue of possible growth and international expansion.

The Company remains financially strong with \$274.4 million in cash and short-term investment securities at the end of the year. During 2011, we repurchased 5.1 million shares of Common Stock for \$127.2 million and have authority to purchase 5.3 million additional shares. Aaron's is well

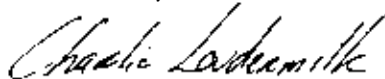
positioned to fund organic growth, take advantage of acquisition opportunities, finance strategic investments, and repurchase stock as deemed appropriate.

Regrettably, Robert C. Loudermilk, Jr., the Company's President and Chief Executive Officer since 2008, resigned in November to pursue personal goals. Robin had ably served the Company in nearly every capacity over the past 29 years, and, as CEO, he oversaw Aaron's tremendous growth and outstanding performance, as well as a significant increase in shareholder value. All of the Aaron's associates join us in thanking Robin for his service to the Company. We were fortunate that Ronald W. Allen, a distinguished long-time Aaron's Director and former Chairman and CEO of Delta Air Lines, quickly stepped in as interim President and Chief Executive Officer. In February 2012, those two roles became permanent and Ron now serves as only the Company's third Chief Executive Officer in its history. Aaron's has a deep, experienced, talented management team and the Company is in good hands.

In addition, in 2011 our valued Director, John C. Portman, Jr., Chairman of Portman Holdings, LLC, stepped down from the Board of Directors after five years of wise counsel and guidance. In October, Cynthia N. Day, President and Chief Executive Officer of Citizen's Trust Bank, joined our Board to fill an open vacancy.

Several other management changes and promotions were made in 2011. Within the Aaron's Sales & Lease Ownership division, Thomas A. Peterson joined Aaron's as Vice President, Marketing, and Brock M. Roberts was elected Vice President of Operations, Northeastern Operations. For the HomeSmart division, Marco A. Scalise was elected Vice President, HomeSmart Operations and Mark A. Rudnick was named Vice President, Marketing, HomeSmart/RIMCO. In January 2012, Jeannie M. Cave joined the Company as Vice President, Real Estate and Construction.

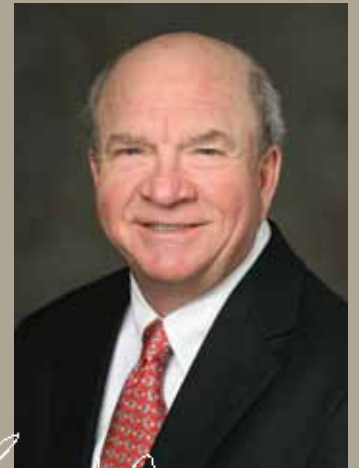
After 57 years, Aaron's is still bringing it home—delivering high-quality household products to our customers, bringing jobs to our communities and bringing investment returns to our shareholders. We are poised to bring home another solid year in 2012. We thank all of you for your support.



R. Charles Loudermilk, Sr.  
Chairman



Ronald W. Allen  
President and Chief Executive Officer

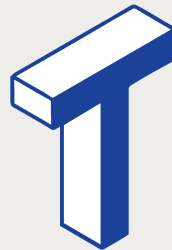




# AFTER 57 YEARS, AARON'S® IS STILL BRINGING IT HOME.

- > Bringing the best business model to the consumer
- > Bringing price, variety and quality to the showroom floor
- > Bringing the message to millions of consumers each year
- > Bringing jobs and service to communities
- > Bringing outstanding returns to investors





his has been the story of Aaron's in times of good employment and easy credit and in times of high unemployment and tight credit.

Aaron's unique sales and lease ownership business model competes with home furnishings retailers serving the middle- and lower-income market, including rent-to-own stores and traditional credit retailers. Over the past 30 years, there has been a significant change in the home furnishings industry. In the 1970s and 1980s, and into the 1990s, home furnishings retailing was dominated by chains offering in-house financing as well as a fragmented rent-to-own market. Well-known brands were among the leaders in the industry and individual stores struggled to compete against the chains. Aaron's was a small regional chain. When the Company completed an initial public offering in 1982, annual revenues were only \$48 million. Since then, many of those national and regional chains are out of business and Aaron's is thriving. Today, Aaron's is one of the nation's largest home furnishings retailers. The Aaron's story has many more chapters to come.

### **Aaron's® brings the best business model to the consumer.**

Aaron's has a distinctive business model which is flexible and can accommodate a wide range of consumer profiles. For the credit-constrained consumer, Aaron's has a no credit check policy, varying lease terms and the ability to terminate a lease with no additional obligation. With a traditional credit card purchase, there is uncertainty on the ultimate cost of the product as interest on unpaid balances accrues monthly. With Aaron's, the total price of ownership of a product can be determined on day one. Aaron's is available when the big box and smaller traditional retailers are reluctant to extend credit and the Aaron's model is better than layaway. No matter how you look at the issue, Aaron's offers a better path to product ownership for the average consumer.

Our best customer is an existing customer and the high level of repeat business is a testimony to the appeal of our business model. Our average customer has a current monthly payment of approximately \$130, which is lower than in previous years. The average lease term has lengthened over the past few years, resulting in reduced monthly payments for our typical customer. The ability to adjust lease terms allows Aaron's to make products more affordable in difficult economic





# BRINGING IT HOME



**KITCHEN:** Refrigerators are the mainstay of the Aaron's kitchen appliance product line and we offer Samsung, Maytag and Frigidaire models from 15 cubic feet to 23 cubic feet capacity. Over 70,000 refrigerators moved through our fulfillment centers last year.



**HOME OFFICE:** Aaron's offers computers for every need and budget. Some customers still prefer desktop computers but laptops are the focus of our product offerings. We leased over 250,000 HP and Toshiba computers in 2011 and introduced the Toshiba tablet in time for the holiday season.



**LAUNDRY ROOM:** Aaron's is proud to offer top-quality brand-name laundry appliances. Our top-selling brands are Amana, Frigidaire, Maytag and LG. Over 150,000 washer/dryer sets were delivered to Aaron's customers in 2011.

**FAMILY ROOM:** Aaron's continually updates its product lines, offering customers the latest products. Over 100,000 Aaron's customers are now enjoying XBOX 360, Sony Playstation and Nintendo Wii gaming systems. We also offer digital cameras, camcorders and blu-ray disc players.

Aaron's purchases more Mitsubishi big-screen televisions than any other retailer in America. We offer a full line of high-definition televisions from a 19" model to an 82" 3-D ready DLP television.

Our customers selected over 400,000 televisions last year.





**LIVING ROOM:** Aaron's delivers over 200,000 pieces of upholstered furniture a year and works closely with manufacturers to offer the latest styling, fabrics and color schemes for all tastes and price points. Because of our buying power, we are able to specify high standards for durability and quality.

The Company has been very successful in offering room packages, accessorizing living room sets with rugs and lamps and decorative items. Aaron's customers brought home over 170,000 lamps in 2011. We are proud to offer a line of high-quality area rugs from Mohawk.

Aaron's even offers top-of-the-line Dyson vacuum cleaners.

**DINING ROOM:** Aaron's is present in every room in the home. We delivered over 50,000 sets of dining room furniture in 2011.

**BEDROOM:** Aaron's delivered over 180,000 mattress sets in 2011. Our Woodhaven division manufactures high-quality bedding with up-to-date styling.



**CHOOSE YOUR PAYMENT TERMS**

**BEST VALUE** **12 MONTHS**

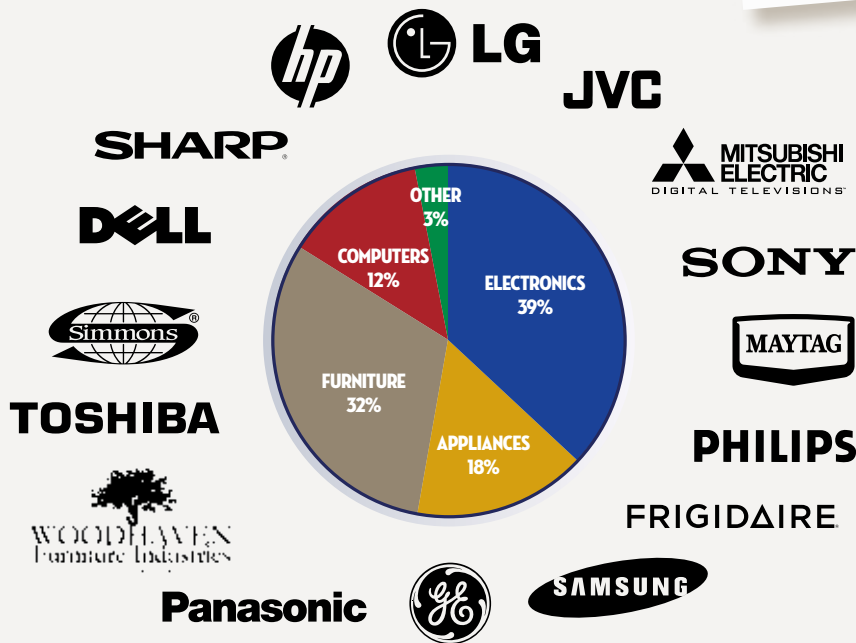
**BUDGET PLAN** **18 MONTHS**

**LOWEST PAYMENT** **24 MONTHS**

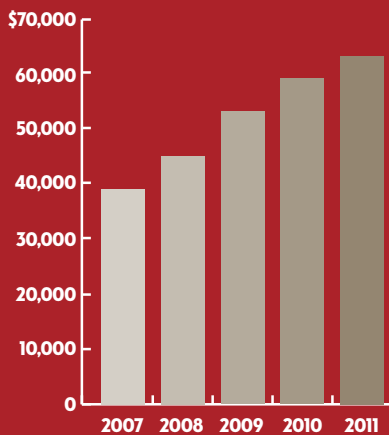
**TO FIT YOUR BUDGET**  
Pay Monthly or Semi-Monthly



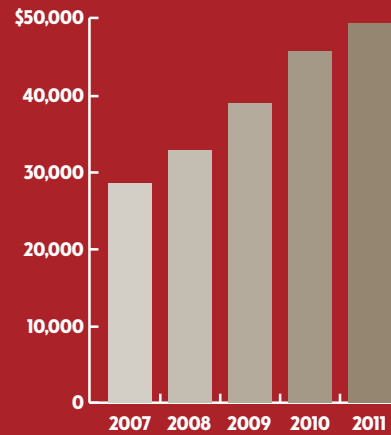
**Company-Operated Sales and Lease Ownership Store Revenues**



**Company Revenues From Franchising**



**Company Pretax Profit From Franchising**





*continued from page 5*

environments. We encourage product ownership and work hard with every customer to craft an affordable and sustainable monthly payment. Over 90% of Aaron's customers are on a monthly payment plan with the remainder paying semi-monthly or weekly.

**Aaron's® brings price, variety and quality to the showroom floor.**

Aaron's has the purchasing power in the market place to secure the best pricing on the best products for our customers. We are constantly working with vendors to bring the latest products to our showrooms at prices our customers can afford.

High-definition televisions have become a signature feature of family rooms and we have models up to over 80 inches in size with the most up-to-date features. We offer gaming systems, computers and now tablet computers. Furniture, bedding, and appliances also remain a significant component of our product offerings.

Our Woodhaven manufacturing division, which supplies the majority of our upholstered furniture and bedding, keeps up with color and style trends and builds durability into all our products. Sixteen fulfillment centers make possible next-day delivery in nearly all of our markets, at no cost to our customer.

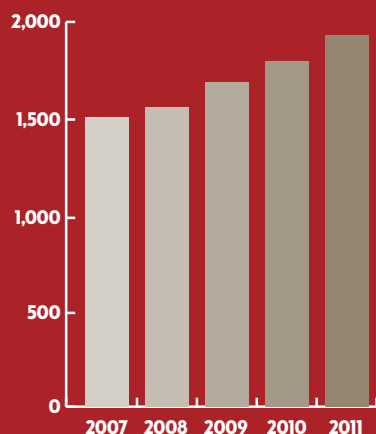
**Aaron's® brings the message to millions of consumers each year.**

As Aaron's stores have come to more and more communities, local marketing has been paired with a national branding campaign. Direct mail circulars to selected neighborhoods are the bread and butter of our marketing program and we now deliver 27 million circulars each month.

Aaron's marketing reaches out into the communities we serve. We have sponsorship agreements with over 30 collegiate athletic programs and numerous professional sports teams. Our signature marketing affiliation for 10 years has been with NASCAR. We sponsor the Michael Waltrip Racing Team with future Hall of Famer Mark Martin driving the No. 55 Aaron's Dream Machine Toyota honoring Charlie Loudermilk's founding of Aaron's in 1955. He'll share the Aaron's Dream Machine with two-time Daytona winner Michael Waltrip who will drive in selected races. The Company sponsors the Aaron's 499 Sprint Cup and the 312 Nationwide Series races at the Aaron's Dream Weekend at the Talladega Superspeedway each year. There are several contests and sweepstakes tied to this event as well as advertising and promotional tie-ins. The Lucky Dog mascot, an integral part of our NASCAR sponsorship, is a popular addition to store openings and promotions.

In 2011, the Company launched its first national advertising program, a key part of our branding program. The goal in 2012 is to have our marketing and branding efforts fully

**Store Growth**



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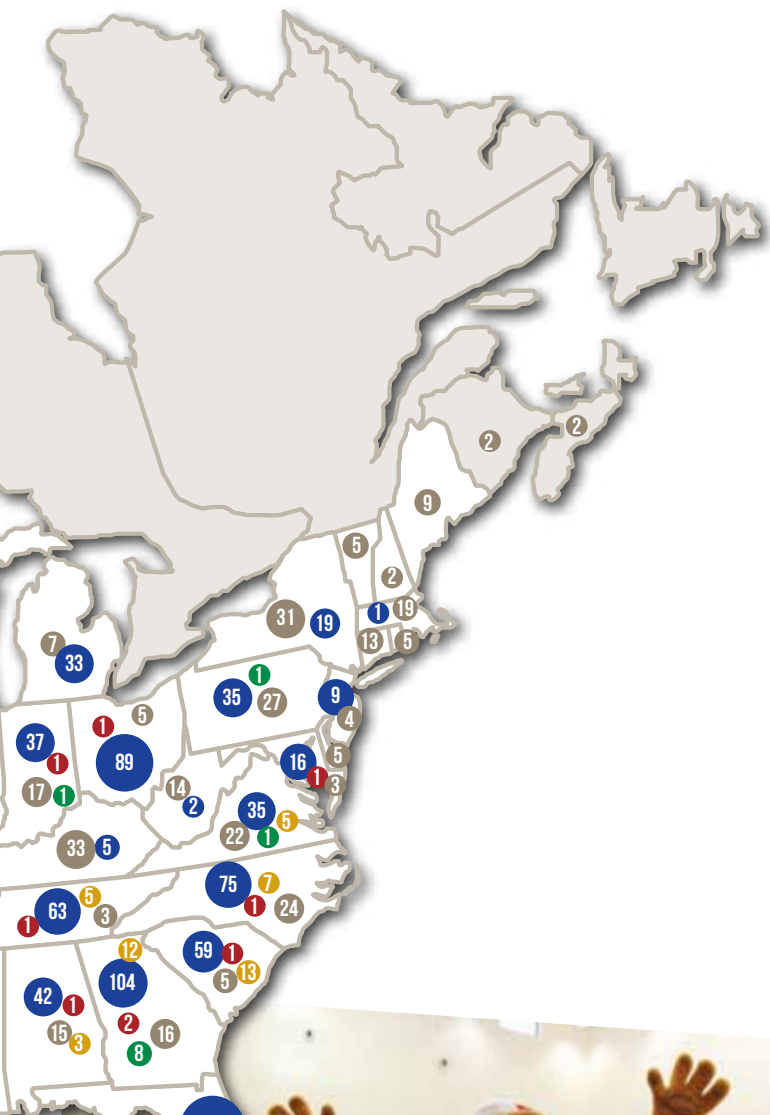


**LOCATIONS WITHIN THE UNITED STATES AND CANADA**

- STORE COUNT AS OF DECEMBER 31, 2011**
- Company Stores – 1,160
  - Franchised Stores – 713
  - HomeSmart Stores – 71
  - Aaron's Office Furniture Stores – 1
  - Fulfillment Centers – 16
  - Woodhaven Furniture Industries – 13







*continued from page 9*

integrated—to be more understandable as a brand, and to be top of mind when consumers think about home furnishings.

**Aaron's® brings jobs and service to communities.**

Aaron's expects to open its 2,000th store in 2012, a remarkable milestone which will be marked by a number of promotions and events. In addition, the Company is investing in HomeSmart, a weekly rental concept. HomeSmart is designed to reach those customers who need the flexibility of a weekly payment plan or who cannot successfully afford the typical Aaron's Sales & Lease Ownership monthly payment. HomeSmart may prove an additional avenue of growth, broadening the market of customers served by the Company and bringing more jobs to more communities.

Aaron's has consistently brought employment opportunities to our communities, creating new jobs each year. The Company now has over 11,200 associates, and a combination of Company-operated and franchised stores in 48 states.

Aaron's is committed to serving our communities. In 2011, for the third year in a row, our national store managers devoted one afternoon to community outreach projects benefiting military service members, children and the community. In conjunction with this day of service, more than 2,000 Aaron's associates invested 4,500 hours and \$200,000 in product and service donations. As part of the donation, the Company presented St. Jude Children's Research Hospital, the nation's top children's cancer hospital, with a check for \$81,200 from funds raised during an associate campaign. Over the past three years of community outreach projects, Aaron's managers have invested 15,700 hours and over \$1 million dollars in product and service donations to surrounding communities.

**Aaron's® brings outstanding returns to investors.**

At the end of 2011, the Company had \$274.4 million in cash and short-term investment securities and an unused line of credit of \$140 million. The Company repurchased 5.1 million shares of stock in 2011 and has an authorization to acquire an additional 5.3 million shares.

We are proud that Aaron's has provided solid investment returns to investors over the years. We have paid cash dividends consistently for 24 years and raised the cash dividend rate by 15% in 2011, the seventh consecutive year of dividend increases. Our operating success is reflected in the market value of the Company which increased 24% in 2011 and our stock price recently reached an all-time high. These results wouldn't be possible without the loyalty of our customers, the hard work of our associates, our many business partners, and the support of our shareholders.

**Aaron's® brings it home ... for 57 years and counting.**



# SELECTED FINANCIAL INFORMATION

(Dollar Amounts in Thousands, Except Per Share)	Year Ended December 31, 2011	Year Ended December 31, 2010	Year Ended December 31, 2009	Year Ended December 31, 2008	Year Ended December 31, 2007
<b>OPERATING RESULTS</b>					
Revenues:					
Lease Revenues and Fees	\$1,516,508	\$1,402,053	\$1,310,709	\$1,178,719	\$1,045,804
Retail Sales	38,557	40,556	43,394	43,187	34,591
Non-Retail Sales	388,960	362,273	327,999	309,326	261,584
Franchise Royalties and Fees	63,255	59,112	52,941	45,025	38,803
Other	16,769	12,853	17,744	16,351	14,157
	2,024,049	1,876,847	1,752,787	1,592,608	1,394,939
Costs and Expenses:					
Retail Cost of Sales	22,738	23,013	25,730	26,379	21,201
Non-Retail Cost of Sales	353,745	330,918	299,727	283,358	239,755
Operating Expenses	872,248	824,929	771,634	705,566	617,106
Lawsuit Expense	36,500	—	—	—	—
Depreciation of Lease Merchandise	550,732	504,105	474,958	429,907	391,538
Interest	4,709	3,096	4,299	7,818	7,587
	1,840,672	1,686,061	1,576,348	1,453,028	1,277,187
Earnings From Continuing Operations Before Income Taxes	183,377	190,786	176,439	139,580	117,752
Income Taxes	69,610	72,410	63,561	53,811	44,327
Net Earnings From Continuing Operations	113,767	118,376	112,878	85,769	73,425
(Loss) Earnings From Discontinued Operations, Net of Tax	—	—	(277)	4,420	6,850
Net Earnings	\$ 113,767	\$ 118,376	\$ 112,601	\$ 90,189	\$ 80,275
Earnings Per Share From Continuing Operations	\$ 1.46	\$ 1.46	\$ 1.39	\$ 1.07	\$ .90
Earnings Per Share From Continuing Operations Assuming Dilution	1.43	1.44	1.38	1.06	.89
Earnings Per Share From Discontinued Operations	.00	.00	.00	.06	.08
(Loss) Earnings Per Share From Discontinued Operations Assuming Dilution	.00	.00	(.01)	.05	.08
Dividends Per Share:					
Common Stock	.054	.049	.046	.043	.041
Former Class A Common Stock	—	.049	.046	.043	.041
<b>FINANCIAL POSITION</b>					
Lease Merchandise, Net	\$ 862,276	\$ 814,484	\$ 682,402	\$ 681,086	\$ 558,322
Property, Plant and Equipment, Net	226,619	204,912	215,183	209,452	228,275
Total Assets	1,735,149	1,502,072	1,321,456	1,233,270	1,113,176
Credit Facilities	153,789	41,790	55,044	114,817	185,832
Shareholders' Equity	976,554	979,417	887,260	761,544	673,380
<b>AT YEAR END</b>					
Stores Open:					
Company-Operated	1,232	1,150	1,097	1,053	1,030
Franchised	713	664	597	504	484
Lease Agreements in Effect	1,508,000	1,325,000	1,171,000	1,017,000	820,000
Number of Associates	11,200	10,400	10,000	9,600	9,100

Earnings per share data has been adjusted for the effect of the 3-for-2 partial stock split distributed on April 15, 2010 and effective April 16, 2010.

# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

## OVERVIEW

Aaron's, Inc. ("we", "our", "us", "Aaron's" or the "Company") is a leading specialty retailer of consumer electronics, computers, residential furniture, household appliances and accessories. Our major operating divisions are the Aaron's Sales & Lease Ownership division, the HomeSmart division and the Woodhaven Furniture Industries division, which manufactures and supplies the majority of the upholstered furniture and bedding leased and sold in our stores.

Aaron's has demonstrated strong revenue growth over the last three years. Total revenues have increased from \$1.753 billion in 2009 to \$2.024 billion in 2011, representing a compound annual growth rate of 7.5%. Total revenues for the year ended December 31, 2011 increased \$147.2 million, or 7.8%, over the prior year.

The majority 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 added a net of 82 Company-operated sales and lease ownership stores in 2011. We spend on average approximately \$600,000 to \$700,000 in the first year of operation of a new store, which includes purchases of lease 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 open more than three years normally achieve approximately \$1.4 million in 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 openings.

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 added a net of 49 stores in 2011. We purchased seven franchised stores during 2011. Franchise royalties and other related fees represent a growing source of high margin revenue for us, accounting for \$63.3 million of revenues in 2011, up from \$52.9 million in 2009, representing a compounded annual growth rate of 9.4%.

**AARON'S OFFICE FURNITURE CLOSURE.** In November 2008, the Company completed the sale of substantially all of the assets and the transfer of certain liabilities of its legacy residential rent-to-rent business, Aaron's Corporate Furnishings division, to CORT Business Services Corporation. When the Company sold its rent-to-rent business, it decided to keep the then 13 Aaron's Office Furniture stores, a rent-to-rent concept aimed at the office market. However, after disappointing results in a difficult environment, in June 2010 the Company announced its plans to close all of the then 12 remaining Aaron's Office Furniture stores and focus solely on the Company's sales and lease ownership business. Since June 2010, the Company has closed 11 of its Aaron's Office Furniture stores and has one remaining store open to liquidate merchandise. As a result, the Company recorded \$9.0 million in 2010 related to the write-down and cost to dispose of office furniture, estimated future lease liabilities for closed stores, write-off of leaseholds, severance pay, and other

costs associated with closing the stores. The Company did not incur charges in 2011 related to closing down the division.

**STOCK SPLIT.** On March 23, 2010, we announced a 3-for-2 stock split effected in the form of a 50% stock dividend on our Common Stock. New shares were distributed on April 15, 2010 to shareholders of record as of the close of business on April 1, 2010. All share and per share information has been restated for all periods presented to reflect this stock split.

**DUAL CLASS UNIFICATION.** In December 2010, the Company's shareholders approved the unification of our prior nonvoting Common Stock and voting Class A Common Stock into a single class. Effective December 10, 2010, the two classes were combined into a single voting class now known simply as our Common Stock.

**SAME STORE REVENUES.** We believe the changes in same store revenues are a key performance indicator. The change in same store revenues is calculated by comparing revenues for the year to revenues for the prior year for all stores open for the entire 24-month period, excluding stores that received lease agreements from other acquired, closed or merged stores.

## KEY COMPONENTS OF NET INCOME

In this management's discussion and analysis section, we review the Company's consolidated results, including the five components of our revenues, costs of sales and expenses, of which depreciation of lease merchandise is a significant part.

**REVENUES.** We separate our total revenues into five components: lease revenues and fees, retail sales, non-retail sales, franchise royalties and fees, and other. Lease revenues and fees include all revenues derived from lease agreements at Company-operated stores, including agreements that result in our customers acquiring ownership at the end of the term. Retail sales represent sales of both new and returned lease merchandise from our stores. Non-retail sales mainly represent new merchandise sales to our Aaron's Sales & 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.

**RETAIL COST OF SALES.** Retail cost of sales represents the original or depreciated cost of merchandise sold through our Company-operated stores.

**NON-RETAIL COST OF SALES.** Non-retail cost of sales primarily represents the cost of merchandise sold to our franchisees.

**OPERATING EXPENSES.** Operating expenses include personnel costs, selling costs, occupancy costs, and delivery, among other expenses.

**LAWSUIT EXPENSE.** Lawsuit expense consists of the cost of paying legal judgments and settlement amounts; defense costs are included in operating expenses.

# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

**DEPRECIATION OF LEASE MERCHANDISE.** Depreciation of lease merchandise reflects the expense associated with depreciating merchandise held for lease and leased to customers by our Company-operated stores.

## CRITICAL ACCOUNTING POLICIES

**REVENUE RECOGNITION.** Lease revenues are recognized in the month they are due on the accrual basis of accounting. For internal management reporting purposes, lease revenues from sales and lease ownership agreements are recognized by the reportable segments as revenue in the month the cash is collected. On a monthly basis, we record an accrual for lease revenues due but not yet received, net of allowances, and a deferral of revenue for lease payments received prior to the month due. Our revenue recognition accounting policy matches the lease revenue with the corresponding costs, mainly depreciation, associated with the lease merchandise. At December 31, 2011 and 2010, we had a revenue deferral representing cash collected in advance of being due or otherwise earned totaling \$43.9 million and \$39.5 million, respectively, and accrued revenue receivable, net of allowance for doubtful accounts, based on historical collection rates of \$5.2 million and \$4.9 million, respectively. Revenues from the sale of merchandise to franchisees are recognized at the time of receipt of the merchandise by the franchisee and revenues from such sales to other customers are recognized at the time of shipment.

**LEASE MERCHANDISE.** Our Aaron's Sales & Lease Ownership and HomeSmart divisions depreciate merchandise over the applicable agreement period, generally 12 to 24 months when leased, and 36 months when not leased, to 0% salvage value. Our Office Furniture store depreciates merchandise over its estimated useful life, which ranges from 24 months to 48 months, net of salvage value, which ranges from 0% to 30%. Sales and lease ownership merchandise is generally depreciated at a faster rate than our office furniture merchandise. Our policies require weekly lease 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 two to four times a year with appropriate provisions made for missing, damaged and unsalable merchandise. In addition, we monitor lease merchandise levels and mix by division, store and fulfillment center, as well as the average age of merchandise on hand. If unsalable lease merchandise cannot be returned to vendors, its carrying value is adjusted to net realizable value or written off. All lease merchandise is available for lease and sale, excluding merchandise determined to be missing, damaged or unsalable.

We record lease 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. Lease merchandise adjustments totaled \$46.2 million, \$46.5 million, and \$38.3 million for the years ended December 31, 2011, 2010, and 2009, respectively. The fiscal year ended

December 31, 2010 includes a write-down of \$4.7 million related to the closure of the Aaron's Office Furniture stores.

**LEASES AND CLOSED STORE RESERVES.** The majority of our Company-operated stores are operated from leased facilities under operating lease agreements. The majority of the leases are for periods that do not exceed five years, although lease terms range in length up to approximately 15 years. Leasehold improvements related to these leases are generally amortized over periods that do not exceed the lesser of the lease term or useful life. While some 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 costs associated with closing stores are the future lease payments and related commitments. We record an estimate of the future obligation related to closed stores based upon the present value of the future lease payments and related commitments, net of estimated sublease income based upon historical experience. As of December 31, 2011 and 2010, our reserve for closed stores was \$3.8 million and \$6.4 million, respectively. Due to changes in the market conditions, our estimates related to sublease income may change and as a result, our actual liability may be more or less than the liability recorded at December 31, 2011.

**INSURANCE PROGRAMS.** We maintain insurance contracts to fund workers compensation, vehicle liability, general liability and group health insurance claims. Using actuarial analysis and projections, we estimate the liabilities associated with open and incurred but not reported workers compensation, vehicle liability and general liability claims. This analysis is based upon an assessment of the likely outcome or historical experience, net of any stop loss or other supplementary coverage. We also calculate the projected outstanding plan liability for our group health insurance program using historical claims runoff data. Our gross estimated liability for workers compensation insurance claims, vehicle liability, general liability and group health insurance was \$28.5 million and \$27.6 million at December 31, 2011 and 2010, respectively. In addition, we have prefunding balances on deposit with the insurance carriers of \$26.4 million and \$23.8 million at December 31, 2011 and 2010, respectively.

If we resolve insurance 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 December 31, 2011.

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.



**LEGAL RESERVES.** We are subject to various legal claims arising in the ordinary course of business. Management regularly assesses the Company's insurance deductibles, analyzes litigation information with the Company's attorneys and evaluates its loss experience. We accrue for litigation loss contingencies that are both probable and reasonably estimable. Legal fees and expenses associated with the defense of all of our litigation are expensed as such fees and expenses are incurred.

**INCOME TAXES.** The calculation of our income tax expense requires significant judgment and the use of estimates. We periodically assess tax positions based on current tax developments, including enacted statutory, judicial and regulatory guidance. In analyzing our overall tax position, consideration is given to the amount and timing of recognizing income tax liabilities and benefits. In applying the tax and accounting guidance to the facts and circumstances, income tax balances are adjusted appropriately through the income tax provision. Reserves for income tax uncertainties are maintained at levels we believe are adequate to absorb probable payments. Actual amounts paid, if any, could differ significantly from these estimates.

We use the liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences

are expected to be recovered or settled. Valuation allowances are established, when necessary, to reduce deferred tax assets when we expect the amount of tax benefit to be realized is less than the carrying value of the deferred tax asset.

**FAIR VALUE.** For the valuation techniques used to determine the fair value of our call option on our PerfectHome investment and assets held for sale, refer to Note A and Note P in the Consolidated Financial Statements.

## RESULTS OF OPERATIONS

### Year Ended December 31, 2011 Versus Year Ended December 31, 2010

For the years ended December 31, 2011 and 2010, the Company's Sales and Lease Ownership, Franchise and HomeSmart segments accounted for substantially all of the operations of the Company and, therefore, unless otherwise noted only the material changes are discussed within these three segments. The entire production of our Manufacturing segment, consisting of our Woodhaven Furniture Industries operation, is leased or sold through our stores, and consequently that segment's revenues and earnings before income taxes are eliminated through the elimination of intersegment revenues and intersegment profit.

(In Thousands)	Year Ended December 31, 2011	Year Ended December 31, 2010	Increase/(Decrease) in Dollars to 2011 from 2010	% Increase/ (Decrease) to 2011 from 2010
<b>REVENUES:</b>				
Lease Revenues and Fees	\$1,516,508	\$1,402,053	\$114,455	8.2%
Retail Sales	38,557	40,556	(1,999)	(4.9)
Non-Retail Sales	389,960	362,273	26,687	7.4
Franchise Royalties and Fees	63,255	59,112	4,143	7.0
Other	16,769	12,853	3,916	30.5
	2,024,049	1,876,847	147,202	7.8
<b>COSTS AND EXPENSES:</b>				
Retail Cost of Sales	22,738	23,013	(275)	(1.2)
Non-Retail Cost of Sales	353,745	330,918	22,827	6.9
Operating Expenses	872,248	824,929	47,319	5.7
Lawsuit Expense	36,500	—	36,500	—
Depreciation of Lease Merchandise	550,732	504,105	46,627	9.2
Interest	4,709	3,096	1,613	52.1
	1,840,672	1,686,061	154,611	9.2
<b>Earnings Before Income Taxes</b>	183,377	190,786	(7,409)	(3.9)
<b>Income Taxes</b>	69,610	72,410	(2,800)	(3.9)
<b>Net Earnings</b>	\$ 113,767	\$ 118,376	\$ (4,609)	(3.9)%

# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

## Revenues

The 7.8% increase in total revenues, to \$2.024 billion in 2011 from \$1.877 billion in 2010, was due mainly to a \$135.2 million, or 7.5%, increase in revenues from the Sales and Lease Ownership segment, a \$15.6 million increase in revenues from the HomeSmart segment and a \$4.1 million, or 7.0%, increase in revenues from the Franchise segment.

Sales and Lease Ownership segment revenues increased due to a 7.2% increase in lease revenues and fees and 7.4% increase in non-retail sales (which mainly represents merchandise sold to our franchisees). Lease revenues and fees within the Sales and Lease Ownership segment increased due to a net addition of 78 Company-operated stores since the beginning of 2010 and a 4.4% increase in same store revenues. Non-retail sales increased primarily due to net additions of 116 franchised stores since the beginning of 2010.

Franchise segment revenues increased due to a \$4.0 million, or 8.4%, increase in royalty income from franchisees. Franchise royalty income increased primarily due to the growth in the number of franchised stores and a 1.3% increase in same store revenues of existing franchised stores. The total number of franchised sales and lease ownership stores at December 31, 2011 was 713, reflecting a net addition of 116 stores since the beginning of 2010.

HomeSmart segment revenues increased to \$15.6 million primarily due to the growth in the number of HomeSmart stores to 71, all of which have been added since the beginning of 2010.

The \$114.5 million increase in lease revenues and fees and \$26.7 million in non-retail sales was primarily attributable to our Sales and Lease Ownership segment discussed above. The \$4.1 million increase in franchise royalties and fees was attributable to our Franchise segment also discussed above.

The 4.9% decrease in retail sales, to \$38.6 million in 2011 from \$40.6 million in the comparable period in 2010, was due primarily to the closure of the majority of the Aaron's Office Furniture stores in 2010.

Other revenues increased 30.5% to \$16.8 million in 2011 from \$12.9 million in 2010 due to a \$1.1 million increase in gains from the sales of stores and a \$1.2 million increase in interest income primarily from investment securities. Included in other revenues in 2011 is a \$3.0 million gain from the sales of 25 Sales and Lease Ownership stores. Included in other revenues in 2010 is a \$1.9 million gain on the sales of 11 Sales and Lease Ownership stores.

## Costs and Expenses

Non-retail cost of sales increased 6.9%, to \$353.7 million in 2011, from \$330.9 million for the comparable period in 2010, and as a percentage of non-retail sales, decreased to 90.9% in 2011 from 91.3% in 2010.

Operating expenses in 2011 increased \$47.3 million to \$872.2 million from \$824.9 million in 2010, a 5.7% increase. As a percentage of total revenues, operating expenses decreased to 43.1% in 2011 from 44.0% in 2010.

We began ceasing the operations of the Aaron's Office Furniture division in June of 2010. We closed 14 Aaron's Office

Furniture stores during 2010 and have one remaining store open to liquidate merchandise. As a result, in 2010 we recorded \$3.3 million in closed store reserves and \$4.7 million in lease merchandise write-downs and other miscellaneous expenses, totaling \$9.0 million in operating expenses, related to the closures. No operating expenses related to the closure were recorded in 2011.

The Company recorded \$36.5 million in lawsuit expense in 2011. There was no similar charge during 2010.

Depreciation of lease merchandise increased \$46.6 million to \$550.7 million in 2011 from \$504.1 million during the comparable period in 2010, a 9.2% increase as a result of higher on-rent lease merchandise due to the growth of our Sales and Lease Ownership and HomeSmart segments. As a percentage of total lease revenues and fees, depreciation of lease merchandise increased slightly to 36.3% from 36.0% in the prior year.

Interest expense increased to \$4.7 million in 2011 compared with \$3.1 million in 2010, a 52.1% decrease. The increase is directly related to the issuance of our senior unsecured notes on July 5, 2011.

Income tax expense decreased \$2.8 million to \$69.6 million in 2011, compared with \$72.4 million in 2010, representing a 3.9% decrease. Our effective tax rate was 38.0% in both 2011 and 2010.

## Net Earnings from Continuing Operations

Net earnings decreased \$4.6 million to \$113.8 million in 2011 compared with \$118.4 million in 2010, representing a 3.9% decrease. Earnings before income taxes decreased \$7.4 million, or 3.9%, primarily due to a \$15.7 million, 9.9%, or, decrease in the Sales and Lease Ownership segment and a \$7.0 million decrease in the HomeSmart segment, offset by a \$3.6 million, or 7.9%, increase in the Franchise segment. As a percentage of total revenues, net earnings from continuing operations were 5.6% and 6.3% in 2011 and 2010, respectively. The decrease in net earnings was primarily the result of the increase litigation expense, offset by an increase in profitability of new Company-operated sales and lease ownership stores added over the past several years, contributing to a 4.4% increase in same store revenues, and a 7.0% increase in franchise royalties and fees.

## Year Ended December 31, 2010 Versus Year Ended December 31, 2009

The Aaron's Corporate Furnishings division is reflected as a discontinued operation for all periods presented. The following table shows key selected financial data for the years ended December 31, 2010 and 2009, and the changes in dollars and as a percentage to 2010 from 2009. For the years ended December 31, 2010 and 2009, the Company's Sales and Lease Ownership segment and the Franchise segment accounted for substantially all of the operations of the Company and, therefore, unless otherwise noted only the material changes are discussed within these two segments. The entire production of our Manufacturing segment, consisting of our Woodhaven Furniture Industries operation, is leased or sold through our stores, and consequently that segment's revenues and earnings before income taxes are eliminated through the elimination of intersegment revenues and intersegment profit.

(In Thousands)	Year Ended December 31, 2010	Year Ended December 31, 2009	Increase/(Decrease) in Dollars to 2010 from 2009	% Increase/ (Decrease) to 2010 from 2009
<b>REVENUES:</b>				
Lease Revenues and Fees	\$1,402,053	\$1,310,709	\$ 91,344	7.0%
Retail Sales	40,556	43,394	(2,838)	(6.5)
Non-Retail Sales	362,273	327,999	34,274	10.4
Franchise Royalties and Fees	59,112	52,941	6,171	11.7
Other	12,853	17,744	(4,891)	(27.6)
	<u>1,876,847</u>	<u>1,752,787</u>	<u>124,060</u>	<u>7.1</u>
<b>COSTS AND EXPENSES:</b>				
Retail Cost of Sales	23,013	25,730	(2,717)	(10.6)
Non-Retail Cost of Sales	330,918	299,727	31,191	10.4
Operating Expenses	824,929	771,634	53,295	6.9
Depreciation of Lease Merchandise	504,105	474,958	29,147	6.1
Interest	3,096	4,299	(1,203)	(28.0)
	<u>1,686,061</u>	<u>1,576,348</u>	<u>109,713</u>	<u>7.0</u>
<b>Earnings From Continuing Operations Before Income Taxes</b>	190,786	176,439	14,347	8.1
<b>Income Taxes</b>	72,410	63,561	8,849	13.9
<b>Net Earnings From Continuing Operations</b>	118,376	112,878	5,498	4.9
<b>Loss From Discontinued Operations, Net of Tax</b>	—	(277)	277	(100.0)
<b>Net Earnings</b>	<u>\$ 118,376</u>	<u>\$ 112,601</u>	<u>\$ 5,775</u>	<u>5.1%</u>

## Revenues

The 7.1% increase in total revenues, to \$1.877 billion in 2010 from \$1.753 billion in 2009, was due mainly to a \$117.9 million or 7.0%, increase in revenues from the Sales and Lease Ownership segment and \$6.2 million, or 11.7%, increase in revenues from the Franchise segment.

Sales and Lease Ownership segment revenues increased due to a 7.3% increase in lease revenues and fees and 10.4% increase in non-retail sales (which mainly represents merchandise sold to our franchisees). Lease revenues and fees within the Sales and Lease Ownership segment increased due to a net addition of 112 Company-operated stores since the beginning of 2009 and a 3.5% increase in same store revenues. Non-retail sales increased primarily due to net additions of 160 franchised stores since the beginning of 2009.

Franchise segment revenues increased due to a \$5.6 million, or 13.2%, increase in royalty income from franchisees. Franchise royalty income increased primarily due to the growth in the number of franchised stores and the maturation of franchised stores opened over the last few years.

The \$91.3 million increase in lease revenues and fees revenues and \$34.3 million in non-retail sales was primarily attributable to our Sales and Lease Ownership segment discussed above. The \$6.2 million increase in franchise royalties and fees was attributable to our Franchise segment also discussed above.

The 6.5% decrease in revenues from retail sales, to \$40.6 million in 2010 from \$43.4 million in the comparable period in 2009, was due primarily to the closure of the majority of the Aaron's Office Furniture stores in 2010.

Other revenues decreased 27.6% to \$12.9 million in 2010 from \$17.7 million in 2009. Included in other revenues in 2010 is a \$1.9 million gain from the sales of 11 stores. Included in other revenues in 2009 is a \$7.8 million gain on the sales of 39 stores.

## Costs and Expenses

Retail cost of sales decreased 10.6% to \$23.0 million in 2010 compared to \$25.7 million in 2009, and as a percentage of retail sales, decreased to 56.7% in 2010 from 59.3% in 2009 primarily as a result of decline in the volume of lower margin office furniture retail sales associated with the closure of 14 Aaron's Office Furniture stores.

Non-retail cost of sales increased 10.4%, to \$330.9 million in 2010, from \$299.7 million for the comparable period in 2009, and as a percentage of non-retail sales, decreased slightly to 91.3% in 2010 from 91.4% in 2009.

Operating expenses in 2010 increased \$53.3 million to \$824.9 million from \$771.6 million in 2009, a 6.9% increase. As a percentage of total revenues, operating expenses were 44.0% for both the year ended December 31, 2010 and 2009.

# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

We began ceasing the operations of the Aaron's Office Furniture segment in June of 2010. We closed 14 Aaron's Office Furniture stores during 2010 and had one remaining store open to liquidate merchandise. As a result, in 2010 we recorded \$3.3 million in closed store reserves and \$4.7 million in lease merchandise write-downs and other miscellaneous expenses, totaling \$9.0 million in operating expenses, related to the closures. In 2009 we recorded a \$2.2 million pre-tax charge to operating expenses relating to the write-down of certain lease merchandise and the impairment of long-lived assets associated with Aaron's Office Furniture stores.

Depreciation of lease merchandise increased \$29.1 million to \$504.1 million in 2010 from \$475.0 million during the comparable period in 2009, a 6.1% increase as a result of higher on-rent lease merchandise due to the growth of our Sales and Lease Ownership segment. Depreciation and amortization in the Other segment decreased \$2.2 million or 24.6% due to the closure of Aaron's Office Furniture stores in 2010. As a percentage of total lease revenues and fees, depreciation of lease merchandise decreased slightly to 36.0% in 2010 from 36.2% in the prior year.

Interest expense decreased to \$3.1 million in 2010 compared with \$4.3 million in 2009, a 28.0% decrease. The decrease in interest expense was due to lower debt levels during 2010.

Income tax expense increased \$8.8 million to \$72.4 million in 2010, compared with \$63.6 million in 2009, representing a 13.9% increase. Our effective tax rate increased to 38.0% in 2010 from 36.0% in 2009 primarily related to the favorable impact of a \$2.3 million reversal of previously recorded liabilities for uncertain tax positions due to the expiration of the statute of limitations in 2009.

## Net Earnings from Continuing Operations

Net earnings from continuing operations increased \$5.5 million to \$118.4 million in 2010 compared with \$112.9 million in 2009, representing a 4.9% increase. Earnings before income taxes from continuing operations increased \$14.3 million, or 8.1%, primarily due to a \$12.2 million, or 8.3%, increase in the Sales and Lease Ownership segment and a \$6.6 million, or 16.8%, increase in the Franchise segment. As a percentage of total revenues, net earnings from continuing operations were 6.3% and 6.4% in 2010 and 2009, respectively. The increase in net earnings from continuing operations was primarily the result of the increase in profitability of new Company-operated stores in our Sales and Lease Ownership segment added over the past several years, contributing to a 3.5% increase in same store revenues, and an 11.7% increase in franchise royalties and fees.

## Balance Sheet

**CASH AND CASH EQUIVALENTS.** The Company's cash balance increased to \$176.3 million at December 31, 2011 from \$72.0 million at December 31, 2010. The \$104.2 million increase in our cash balance is due to cash flow generated from operations, less cash used by investing and financing activities. For additional information, refer to the "Liquidity and Capital Resources" section below.

**INVESTMENT SECURITIES.** Our investment securities balance was \$98.1 million at December 31, 2011 primarily as a result of purchases of corporate bonds in 2011 and an investment in bonds issued by a privately-held rent-to-own company based in the United Kingdom. The securities are recorded at amortized cost in the consolidated balance sheets and mature at various dates in the period April 2012 to December 2013. We did not hold any investment securities at December 31, 2010.

**LEASE MERCHANDISE, NET.** The increase of \$47.8 million in lease merchandise, net of accumulated depreciation, to \$862.3 million at December 31, 2011 from \$814.5 million at December 31, 2010, is primarily the result of a net increase in lease merchandise of \$24.9 million in the Sales and Lease Ownership segment and \$25.9 million in the HomeSmart segment.

**PROPERTY, PLANT AND EQUIPMENT, NET.** The increase of \$21.7 million in property, plant and equipment, net of accumulated depreciation, to \$226.6 million at December 31, 2011 from \$204.9 million at December 31, 2010, is primarily due to \$10.1 million in net additions resulting from the growth of the HomeSmart segment and \$6.3 million in net additions from the growth of the Sales and Lease Ownership segment.

**GOODWILL, NET.** The \$17.0 million increase in goodwill, to \$219.3 million on December 31, 2011 from \$202.4 million on December 31, 2010, is the result of a series of acquisitions of sales and lease ownership businesses. During 2011, the Company acquired 38 Sales and Lease Ownership stores with an aggregate purchase price of \$17.5 million. The Company acquired 47 stores that were converted to HomeSmart with an aggregate purchase price of \$23.9 million. The principal tangible assets acquired consisted of lease merchandise, vehicles and certain fixtures and equipment.

**PREPAID EXPENSES AND OTHER ASSETS.** Prepaid expenses and other assets decreased \$73.8 million to \$49.1 million at December 31, 2011 from \$122.9 million at December 31, 2010, primarily as a result of a decrease in prepaid income taxes primarily as a result of the receipt of an \$80.9 million income tax refund in February 2011.

**ACCOUNTS PAYABLE AND ACCRUED EXPENSES.** The increase of \$20.1 million in accounts payable and accrued expenses, to \$231.6 million at December 31, 2011 from \$211.5 million at December 31, 2010, is primarily the result of fluctuations in the timing of payments.

**ACCRUED LITIGATION EXPENSE.** Accrued litigation expense increased \$40.0 million to \$41.7 million at December 31, 2011 from \$1.7 million at December 31, 2010. In 2011 the Company accrued \$41.5 million, which represents the judgment, as reduced, and associated legal fees and expenses related to the *Alford v. Aarons Rents, Inc. et al* case discussed in Item 3, "Legal Proceedings" of our Annual Report on Form 10-K for the year ended December 31, 2011 filed with the SEC and in Note F to our Consolidated Financial Statements. Additional positive or negative developments in the lawsuit could affect the assumptions, and therefore, the accrual. The Company has also recorded insurance coverage receivable of \$5 million in prepaid expenses and other assets on the consolidated balance sheet as of December 31, 2011



**DEFERRED INCOME TAXES PAYABLE.** The increase of \$59.5 million in deferred income taxes payable to \$287.0 million at December 31, 2011 from \$227.5 million at December 31, 2010 is primarily the result of bonus lease merchandise depreciation deductions for tax purposes included in the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010.

**CREDIT FACILITIES.** The \$112.0 million increase in the amounts we owe under our credit facilities, to \$153.8 million on December 31, 2011 from \$41.8 million on December 31, 2010, reflects net borrowings under our note purchase agreement during 2011 primarily to fund purchases of lease merchandise, acquisitions, real estate, investments, working capital and repurchases of our Common Stock, offset by regularly schedule payments.

## LIQUIDITY AND CAPITAL RESOURCES

### General

Cash flows from continuing operations for the year ended December 31, 2011, 2010 and 2009 were \$307.2 million, \$49.3 million and \$193.7 million, respectively, due to increases in cash flows from operating activities. The \$257.9 million increase in cash flows from operating activities is primarily related to lower 2011 tax payments, tax refunds and income from operations.

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 lease 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 have an initial positive effect on operating cash flows that may not be indicative of the extent of their contributions in future periods. The amount of lease merchandise purchased in acquisitions of Aaron's Sales & Lease Ownership stores and shown under investing activities was \$6.1 million in 2011, \$6.5 million in 2010 and \$9.5 million in 2009. Sales of Sales and Lease Ownership stores are an additional source of investing cash flows in each period presented. Proceeds from such sales were \$16.5 million in 2011, \$8.0 million in 2010 and \$32.0 million in 2009. The amount of lease merchandise sold in these sales and shown under investing activities was \$8.9 million in 2011, \$4.5 million in 2010 and \$16.3 million in 2009. The amount of HomeSmart merchandise purchased in acquisitions of sales and lease ownership stores and shown under investing activities was \$7.3 million in 2011. There were no purchases of HomeSmart stores in 2010 and 2009 and no sales activity in 2011, 2010 or 2009.

Our cash flows include profits on the sale of lease return merchandise. Our primary capital requirements consist of buying lease merchandise for sales and lease ownership stores. As we continue to grow, the need for additional lease merchandise will remain our major capital requirement. Other capital requirements include purchases of property, plant and equipment, expenditures for

acquisitions and income tax payments. These capital requirements historically have been financed through:

- cash flow from operations;
- bank credit;
- trade credit with vendors;
- proceeds from the sale of lease return merchandise;
- private debt offerings; and
- stock offerings.

At December 31, 2011, there was no outstanding balance under our revolving credit agreement. The credit facilities balance increased by \$112.0 million in 2011 primarily as a result of the addition of senior unsecured notes in July 2011 and was offset by \$12.0 million in payments during the period for previously outstanding debt. Our revolving credit facility expires May 23, 2013 and the total available credit under the facility is \$140.0 million.

We have \$12.0 million currently outstanding in aggregate principal amount of 5.03%, senior unsecured notes due July 2012.

On July 5, 2011, the Company entered into a note purchase agreement with several insurance companies. Pursuant to this agreement, the Company and its subsidiary, Aaron Investment Company, as co-obligors issued \$125.0 million in senior unsecured notes to the purchasers in a private placement. The notes bear interest at the rate of 3.75% per year and mature on April 27, 2018. Payments of interest are due quarterly, commencing July 27, 2011, with principal payments of \$25.0 million each due annually commencing April 27, 2014.

Our revolving credit agreement and senior unsecured notes, and our franchisee loan program discussed below, contain certain financial covenants. These covenants include requirements that we maintain ratios of: (1) EBITDA plus lease expense to fixed charges of no less than 2:1; (2) total debt to EBITDA of no greater than 3:1; and (3) total debt to total capitalization of no greater than 0.6:1. "EBITDA" in each case means consolidated net income before interest and tax expense, depreciation (other than lease merchandise depreciation) and amortization expense, and other non-cash charges. The Company is also required to maintain a minimum amount of shareholders' equity. See the full text of the covenants in our credit and guarantee agreements, which we have filed as exhibits to our Securities and Exchange Commission reports, for the details of these covenants and other terms. 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 December 31, 2011 and believe that we will continue to be in compliance in the future.

We purchase our stock in the market from time to time as authorized by our board of directors. In May 2011, the Board of Directors approved and authorized the repurchase of an additional 5,955,204 shares of Common Stock over the previously authorized repurchase amount of 4,044,796 shares, increasing the total number of our shares of Common Stock authorized for repurchase to 10,000,000. We repurchased 5,075,675 shares of Common Stock

# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

during 2011 at a total purchase price of \$127.2 million and have authority to purchase 5,281,344 additional shares. The repurchases in 2011 increased the diluted earnings per share by \$.04.

We have a consistent history of paying dividends, having paid dividends for 24 consecutive years. A \$.0113 per share dividend on our common shares was paid in January 2009, April 2009, July 2009, and October 2009. Our board of directors increased the dividend 6.2% for the fourth quarter of 2009 on November 4, 2009 to \$.012 per share and was paid in December 2009. A \$.012 per share dividend on our common shares was paid in January 2010, April 2010, July 2010, and October 2010 for a total cash outlay of \$3.9 million. Our board of directors increased the dividend 8.3% for the fourth quarter of 2010 on November 3, 2010 to \$.013 per share and the dividend was paid to holders of Common Stock in January 2011. A \$.013 per share dividend on Common Stock was paid in April 2011, July 2011 and October 2011 for a total cash outlay of \$3.1 million. Our board of directors increased the dividend 15.4% for the fourth quarter of 2011 on November 1, 2011 to \$.015 per share and the dividend was paid to holders of Common Stock in January 2012. 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 will supplement our expected cash flows from operations, existing credit facilities, vendor credit and proceeds from the sale of lease 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 12 and 24 months. We believe we can secure these additional sources of capital in the ordinary course of business. However, if the credit and capital markets experience disruptions, we may not be able to obtain access to capital at as favorable costs as we have historically been able to, and some forms of capital may not be available at all.

## COMMITMENTS

**INCOME TAXES.** During the twelve months ended December 31, 2011, we made \$11.0 million in income tax payments. Within the next twelve months, we anticipate that we will make cash payments for federal and state income taxes of approximately \$141.0 million. In September 2010 the Small Business Jobs Act of 2010 was enacted and in December 2010, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 was enacted. As a result of the bonus depreciation provisions in these acts, in 2010 we made estimated payments greater than our anticipated 2010 federal tax liability. We filed for a refund of overpaid federal tax of approximately \$80.9 million in January 2011 and received that refund in February 2011.

The Economic Stimulus Act of 2008, the American Recovery and Reinvestment Act of 2009, and the Small Business Jobs Act of 2010 provided for accelerated depreciation by allowing a bonus first-year depreciation deduction of 50% of the adjusted basis of qualified property, such as our lease merchandise, placed in service

during those years. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 allowed for deduction of 100% of the adjusted basis of qualified property for assets placed in service after September 8, 2010 and before December 31, 2011. Accordingly, our cash flow benefited from having a lower cash tax obligation which, in turn, provided additional cash flow from operations. Because of our sales and lease ownership model where the Company remains the owner of merchandise on lease, we benefit more from bonus depreciation, relatively, than traditional furniture, electronics and appliance retailers. In future years, we anticipate having to make increased tax payments on our earnings as a result of expected profitability and the reversal of the accelerated depreciation deductions that were taken in 2011 and prior periods. We estimate that at December 31, 2011 the remaining tax deferral associated with the acts described above is approximately \$240.0 million, of which approximately 70% will reverse in 2012 and most of the remainder will reverse between 2013 and 2014.

**LEASES.** We lease warehouse and retail store space for most of our operations under operating leases expiring at various times through 2028. 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 December 31, 2011 are shown in the below table under "Contractual Obligations and Commitments."

We have 20 capital leases, 19 of which are with a limited liability company ("LLC") whose managers and owners are 10 officers and one former officer of the Company of which there are seven executive officers, with no individual, owning more than 13.33% of the LLC. Nine of these related party leases relate to properties purchased from us 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 us for a 15-year term, with a five-year renewal at our option, at an aggregate annual lease amount of \$716,000. Another ten of these related party leases relate to properties purchased from us in December 2002 by the LLC for a total purchase price of approximately \$5.0 million. The LLC is leasing back these properties to us for a 15-year term at an aggregate annual lease of \$556,000. We do not currently plan to enter into any similar related party lease transactions in the future.

We finance a portion of our store expansion through sale-leaseback transactions. The properties are generally 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.

**FRANCHISE 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 May 18, 2011, we entered into a second amendment to our second amended and restated loan facility and guaranty, dated June 18, 2010, as amended, and on July 1, 2011, we entered into a third amendment. The amendments to the franchisee loan facility extended the maturity date until May 16, 2012, increased the maximum Canadian subfacility commitment amount for loans to franchisees that operate stores in Canada (other than in the Province of Quebec) from Cdn \$25.0 million to Cdn \$35.0 million, and added the defined terms “Institutional Investor” and “Private Placement Debt” to further clarify the circumstances under which we may incur indebtedness and still remain in compliance with applicable negative covenants, modified the negative covenant restricting debt applicable to us by, among other things, increasing the amount of indebtedness we may incur with respect to certain privately placed debt from an aggregate principal amount of up to \$60.0 million to an aggregate principal amount of up to \$150 million, replaced the pricing grid schedule to the franchisee loan facility to reduce the applicable margins and participant unused commitment fee percentages with respect to the funded participations, and permitted the issuance of our 3.75% unsecured senior notes issued to several insurance companies as described above under the heading “Liquidity and Capital Resources—General.” We remain subject to the financial covenants under the franchisee loan facility.

At December 31, 2011, the portion that we might be obligated to repay in the event franchisees defaulted was \$128.8 million. Of this amount, approximately \$108.5 million represents franchise borrowings outstanding under the franchisee loan program and approximately \$20.3 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 lease merchandise and other assets. Since its inception in 1994, we have had no significant losses associated with the franchise loan and guaranty

program. We believe the likelihood of any significant amounts being funded in connection with these commitments to be remote. We receive guarantee fees based on such franchisees’ outstanding debt obligations, which were recognized as the guarantee obligation is satisfied.

**LEGAL RESERVES.** We are frequently a party to various legal proceedings arising in the ordinary course of business. Management regularly assesses the Company’s insurance deductibles, analyzes litigation information with the Company’s attorneys and evaluates its loss experience. We accrue for litigation loss contingencies that are both probable and reasonably estimable. Legal fees and expenses associated with the defense of all of our litigation are expensed as such fees and expenses are incurred. Some of the proceedings we are currently a party to are described in Item 3, “Legal Proceedings” of our Annual Report on Form 10-K for the year ended December 31, 2011 filed with the SEC and in Note F to our Consolidated Financial Statements.

Accrued litigation expense increased \$40.0 million to \$41.7 million at December 31, 2011 from \$1.7 million at December 31, 2010, substantially due to the *Alford v. Aarons Rents, Inc. et al.* case discussed in Item 3 of our Annual Report on Form 10-K for the year ended December 31, 2011 filed with the SEC and in Note F to our Consolidated Financial Statements.

While we do not presently believe that any of the legal proceedings to which we are currently a party will ultimately have a material adverse impact upon our business, financial position or results of operations, there can be no assurance that we will prevail in all the proceedings we are party to, or that we will not incur material losses from them.

**CONTRACTUAL OBLIGATIONS AND COMMITMENTS.** We have no long-term commitments to purchase merchandise. See Note F to the Consolidated Financial Statements for further information. The following table shows our approximate contractual obligations, including interest, and commitments to make future payments as of December 31, 2011:

Contractual Obligations and Commitments (In Thousands)	Total Amounts Committed	Period Less Than 1 Year	Period 1–3 Years	Period 3–5 Years	Period Over 5 Years
Credit Facilities, Excluding Capital Leases	\$173,703	\$ 17,228	\$ 34,475	\$ 62,625	\$ 59,375
Capital Leases	16,359	2,030	4,244	4,276	5,809
Operating Leases	532,810	100,906	160,296	96,983	174,625
Purchase Obligations	38,998	19,761	19,237	—	—
Total Contractual Cash Obligations	\$761,870	\$139,925	\$218,252	\$163,884	\$239,809

The following table shows the Company’s approximate commercial commitments as of December 31, 2011:

(In Thousands)	Total Amounts Committed	Period Less Than 1 Year	Period 1–3 Years	Period 3–5 Years	Period Over 5 Years
Guaranteed Borrowings of Franchisees	\$128,761	\$128,222	\$ 539	\$ —	\$ —

# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Purchase obligations are primarily related to certain advertising and marketing programs. We do not have significant agreements for the purchase of lease merchandise or other goods specifying minimum quantities or set prices that exceed our expected requirements for three months.

Deferred income tax liabilities as of December 31, 2011 were approximately \$287.0 million. This amount is not included in the total contractual obligations table because we believe this presentation would not be meaningful. Deferred income tax liabilities are calculated based on temporary differences between the tax basis of assets and liabilities and their respective book basis, which will result in taxable amounts in future years when the liabilities are settled at their reported financial statement amounts. The results of these calculations do not have a direct connection with the amount of cash taxes to be paid in any future periods. As a result, scheduling deferred income tax liabilities as payments due by period could be misleading, because this scheduling would not relate to liquidity needs.

## RECENT ACCOUNTING PRONOUNCEMENTS

In May 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2011-4, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS* ("ASU 2011-4"). ASU 2011-4 is intended to improve the comparability of fair value

measurements presented and disclosed in financial statements prepared in accordance with U.S. Generally Accepted Accounting Principles and International Financial Reporting Standards. The amendments are of two types: (i) those that clarify the FASB's intent about the application of existing fair value measurement and disclosure requirements and (ii) those that change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. ASU 2011-4 is effective for annual periods beginning after December 15, 2011.

## QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As of December 31, 2011, we had \$12.0 million and \$125.0 million of senior unsecured notes outstanding at a fixed rate of 5.03% and 3.75%, respectively. We had no balance outstanding under our revolving credit agreement indexed to the LIBOR ("London Interbank Offer Rate") or the prime rate, which exposes us to the risk of increased interest costs if interest rates rise. Based on our overall interest rate exposure at December 31, 2011, a hypothetical 1.0% increase or decrease in interest rates would not be material.

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



# CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Share Data)	December 31, 2011	December 31, 2010
<b>ASSETS:</b>		
Cash and Cash Equivalents	\$ 176,257	\$ 72,022
Investment Securities	98,132	—
Accounts Receivable (net of allowances of \$4,768 in 2011 and \$4,544 in 2010)	87,471	69,662
Lease Merchandise	1,363,903	1,280,457
Less: Accumulated Depreciation	(501,627)	(465,973)
	862,276	814,484
Property, Plant and Equipment, Net	226,619	204,912
Goodwill, Net	219,342	202,379
Other Intangibles, Net	6,066	3,832
Prepaid Expenses and Other Assets	49,101	122,932
Assets Held for Sale	9,885	11,849
Total Assets	\$1,735,149	\$1,502,072
<b>LIABILITIES &amp; SHAREHOLDERS' EQUITY:</b>		
Accounts Payable and Accrued Expenses	\$ 231,553	\$ 211,462
Accrued Litigation Expense	41,720	1,677
Deferred Income Taxes Payable	286,962	227,513
Customer Deposits and Advance Payments	44,571	40,213
Credit Facilities	153,789	41,790
Total Liabilities	758,595	522,655
Shareholders' Equity:		
Common Stock, Par Value \$.50 Per Share; Authorized: 225,000,000 Shares at December 31, 2011 and 2010 Shares Issued: 90,752,123 at December 31, 2011 and 2010	45,376	45,376
Additional Paid-in Capital	212,311	201,752
Retained Earnings	918,699	809,084
Accumulated Other Comprehensive Income	274	846
	1,176,660	1,057,058
Less: Treasury Shares at Cost, Common Stock, 15,111,635 and 10,664,728 Shares at December 31, 2011 and 2010, respectively	(200,106)	(77,641)
Total Shareholders' Equity	976,554	979,417
Total Liabilities & Shareholders' Equity	\$1,735,149	\$1,502,072

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

# CONSOLIDATED STATEMENTS OF EARNINGS

(In Thousands, Except Per Share)	Year Ended December 31, 2011	Year Ended December 31, 2010	Year Ended December 31, 2009
<b>REVENUES:</b>			
Lease Revenues and Fees	\$1,516,508	\$1,402,053	\$1,310,709
Retail Sales	38,557	40,556	43,394
Non-Retail Sales	388,960	362,273	327,999
Franchise Royalties and Fees	63,255	59,112	52,941
Other	16,769	12,853	17,744
	2,024,049	1,876,847	1,752,787
<b>COSTS AND EXPENSES:</b>			
Retail Cost of Sales	22,738	23,013	25,730
Non-Retail Cost of Sales	353,745	330,918	299,727
Operating Expenses	872,248	824,929	771,634
Lawsuit Expense	36,500	—	—
Depreciation of Lease Merchandise	550,732	504,105	474,958
Interest	4,709	3,096	4,299
	1,840,672	1,686,061	1,576,348
<b>Earnings From Continuing Operations Before Income Taxes</b>	183,377	190,786	176,439
<b>Income Taxes</b>	69,610	72,410	63,561
<b>Net Earnings From Continuing Operations</b>	113,767	118,376	112,878
<b>Loss From Discontinued Operations, Net of Tax</b>	—	—	(277)
<b>Net Earnings</b>	\$ 113,767	\$ 118,376	\$ 112,601
<b>Earnings Per Share From Continuing Operations</b>	\$ 1.46	\$ 1.46	\$ 1.39
<b>Earnings Per Share From Continuing Operations Assuming Dilution</b>	1.43	1.44	1.38
<b>Earnings Per Share From Discontinued Operations</b>	.00	.00	.00
<b>Loss Per Share From Discontinued Operations Assuming Dilution</b>	.00	.00	(.01)

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

# CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(In Thousands, Except Per Share)	Treasury Stock		Common Stock	Additional Paid-In Capital	Retained Earnings	Comprehensive Income	Accumulated Other Comprehensive (Loss) Income	
	Shares	Amount					Foreign Currency Translation	Marketable Securities
<b>BALANCE, JANUARY 1, 2009</b>	(10,280)	\$ (47,405)	\$45,378	\$179,191	\$585,827	\$(1,359)	\$(88)	
Dividends, \$.046 Per share					(3,739)			
Stock-Based Compensation				3,565				
Exchange of Common Stock for Class A Common Stock	(144)	(9,073)		9,073				
Reissued Shares	1,026	7,103		4,840				
Net Earnings From Continuing Operations					112,878	\$112,878		
Loss From Discontinued Operations					(277)	(277)		
Foreign Currency Translation Adjustment						1,346	—	
Comprehensive Income						113,947		
<b>BALANCE, DECEMBER 31, 2009</b>	(9,398)	(49,375)	45,378	196,669	694,689	(13)	(88)	
Dividends, \$.049 per share					(3,981)			
Stock-Based Compensation				4,759				
Reissued Shares	212	743		324				
Repurchased Shares	(1,479)	(29,009)						
Stock Recombination			(2)					
Net Earnings					118,376	118,376		
Foreign Currency Translation Adjustment, net of Income Taxes of \$356						947	—	
Comprehensive Income						119,323		
<b>BALANCE, DECEMBER 31, 2010</b>	(10,665)	(77,641)	45,376	201,752	809,084	578	(88)	
Dividends, \$.054 per share					(4,152)			
Stock-Based Compensation				8,385				
Reissued Shares	737	7,493		2,174				
Repurchased Shares	(5,184)	(129,958)						
Stock Recombination								
Net Earnings					113,767	113,767		
Reclassification Into Earnings of Available for Sale Securities, net of Taxes of \$54							88	
Foreign Currency Translation Adjustment, net of Income Taxes of \$187						(304)	(304)	
Comprehensive Income						\$113,463		
<b>BALANCE, DECEMBER 31, 2011</b>	(15,112)	\$(200,106)	\$45,376	\$212,311	\$918,699	\$ 274	\$ —	

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

# CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)	Year Ended December 31, 2011	Year Ended December 31, 2010	Year Ended December 31, 2009
<b>CONTINUING OPERATIONS</b>			
<b>OPERATING ACTIVITIES:</b>			
Net Earnings from Continuing Operations	\$ 113,767	\$ 118,376	\$ 112,878
Depreciation of Lease Merchandise	550,732	504,105	474,958
Other Depreciation and Amortization	52,832	45,427	44,413
Additions to Lease Merchandise	(1,024,602)	(1,034,474)	(847,094)
Book Value of Lease Merchandise Sold or Disposed	430,540	400,304	363,975
Change in Deferred Income Taxes	59,449	63,843	15,032
Bad Debt Expense	25,402	23,988	20,469
Loss on Sale of Property, Plant, and Equipment	1,172	2,441	1,136
Gain on Dispositions of Business and Contracts	(3,045)	(1,917)	(7,826)
Change in Income Tax Receivable	79,762	(82,378)	28,443
Change in Accounts Payable and Accrued Expenses	20,916	33,969	2,410
Change in Accrued Litigation Expense	40,043	1,352	(396)
Change in Accounts Receivable	(43,211)	(27,555)	(27,051)
Excess Tax Benefits from Stock-Based Compensation	(1,264)	(321)	(3,909)
Change in Other Assets	(6,348)	(4,943)	3,356
Change in Customer Deposits	4,358	2,015	4,763
Stock-Based Compensation	8,385	4,759	3,696
Other Changes, Net	(1,693)	270	4,441
Cash Provided by Operating Activities	307,195	49,261	193,694
<b>INVESTING ACTIVITIES:</b>			
Additions to Property, Plant and Equipment	(78,211)	(87,636)	(83,140)
Acquisitions of Businesses and Contracts	(32,176)	(17,891)	(25,202)
Purchase of Investment Securities	(100,513)	—	—
Proceeds from Calls of Investment Securities	1,063	—	—
Proceeds from Dispositions of Businesses and Contracts	7,282	8,025	32,042
Proceeds from Sale of Property, Plant, and Equipment	11,481	53,399	37,533
Cash Used by Investing Activities	(191,074)	(44,103)	(38,767)
<b>FINANCING ACTIVITIES:</b>			
Proceeds from Credit Facilities	129,150	2,429	57,383
Repayments on Credit Facilities	(17,151)	(15,683)	(117,156)
Dividends Paid	(4,073)	(2,929)	(4,649)
Excess Tax Benefits from Stock-Based Compensation	1,264	321	3,909
Acquisition of Treasury Stock	(127,193)	(28,046)	—
Issuance of Stock Under Stock Option Plans	6,117	1,087	8,172
Cash Used by Financing Activities	(11,886)	(42,821)	(52,341)
<b>DISCONTINUED OPERATIONS:</b>			
Operating Activities	—	—	(277)
Cash Used by Discontinued Operations	—	—	(277)
Increase (Decrease) in Cash and Cash Equivalents	104,235	(37,663)	102,309
Cash and Cash Equivalents at Beginning of Year	72,022	109,685	7,376
Cash and Cash Equivalents at End of Year	\$ 176,257	\$ 72,022	\$ 109,685
<b>Cash Paid During the Year:</b>			
Interest	\$ 3,983	\$ 3,203	\$ 4,591
Income Taxes	10,991	94,793	15,286

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



# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS



## NOTE A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

*As of December 31, 2011 and 2010, and for the Years Ended December 31, 2011, 2010 and 2009.*

**BASIS OF PRESENTATION**—The consolidated financial statements include the accounts of Aaron's, Inc. and its wholly owned subsidiaries (the "Company" or "Aaron's"). All significant intercompany accounts and transactions have been eliminated. The preparation of the Company's consolidated financial statements in conformity with United States generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in these financial statements and accompanying notes. Actual results could differ from those estimates. Generally, actual experience has been consistent with management's prior estimates and assumptions. Management does not believe these estimates or assumptions will change significantly in the future absent unanticipated or unforeseen events.

On December 7, 2010, at a special meeting of the Company's shareholders, such shareholders approved a proposal to amend and restate the Company's Amended and Restated Articles of Incorporation to: (i) convert each outstanding share of Common Stock, par value \$0.50 per share (the "Nonvoting Common Stock") into one share of Class A Common Stock (the "Class A Common Stock") and to rename the Class A Common Stock as Common Stock (the "Common Stock"), (ii) eliminate certain obsolete provisions relating to the Company's prior dual-class common stock structure, and (iii) amend the number of authorized shares to be 225,000,000 total shares of Common Stock (the aggregate of the number of authorized shares of Nonvoting Common Stock and Class A Common Stock prior to the approval of the Amended and Restated Articles of Incorporation). Following receipt of shareholder approval at the special meeting, the Amended and Restated Articles of Incorporation were filed with the Secretary of State of the State of Georgia and are now effective.

As a result of the reclassification of shares of Nonvoting Common Stock into shares of Class A Common Stock and the other changes described above and effected by the Amended and Restated Articles of Incorporation, shares of the combined class now titled Common Stock have one vote per share on all matters submitted to the Company's shareholders, including the election of directors. The former Nonvoting Common Stock did not entitle the holders thereof to any vote except as otherwise provided in the Company's Articles of Incorporation or required by law. In addition, holders of the combined class now titled Common Stock will all vote as a single class of stock on any matters subject to a shareholder vote. Holders of the former Class A Common Stock and the Nonvoting Common Stock were previously entitled to separate class voting rights in certain circumstances as required by law, and those class voting rights were eliminated with the share reclassification.

The holders of Common Stock are entitled to receive dividends and other distributions in cash, stock or property of the Company as and when declared by the Board of Directors of the Company out of legally available funds. Prior to the conversion, the Company's Articles of Incorporation permitted the payment of a cash dividend on the Nonvoting Common Stock without paying any dividend on the Class A Common Stock or the payment of a cash dividend on the Nonvoting Common Stock that was up to 50% higher than any dividend paid on the Class A Common Stock. Cash dividends could not be paid on the Class A Common Stock unless equal or higher dividends were paid on the Nonvoting Common Stock.

The conversion had no other impact on the economic equity interests of holders of Common Stock, including with regards to liquidation rights or redemption, regardless of whether holders previously held shares of Nonvoting Common Stock or Class A Common Stock.

On March 23, 2010, the Company announced a 3-for-2 stock split effected in the form of a 50% stock dividend on both Nonvoting Common Stock and Class A Common Stock. New shares were distributed on April 15, 2010 to shareholders of record as of the close of business on April 1, 2010. All share and per share information has been restated for all periods presented to reflect this stock split.

Certain reclassifications have been made to the prior periods to conform to the current period presentation. In all periods presented, the HomeSmart division was reclassified from the Other segment to the HomeSmart segment. Refer to Note K for the segment disclosure. In all periods presented, bad debt expense was reclassified from change in accounts receivable to a separate bad debt expense line on the consolidated statements of cash flows.

**LINE OF BUSINESS**—The Company is a specialty retailer engaged in the business of leasing and selling residential furniture, consumer electronics, appliances, computers, and other merchandise throughout the U.S. and Canada. The Company's entire production of furniture and bedding is shipped to Aaron's Company-operated and franchise stores.

**LEASE MERCHANDISE**—The Company's lease merchandise consists primarily of residential furniture, consumer electronics, appliances, computers, and other merchandise and is recorded at cost, which includes overhead from production facilities, shipping costs and warehousing costs. The sales and lease ownership stores depreciate merchandise over the lease agreement period, generally 12 to 24 months when on lease and 36 months when not on lease, to a 0% salvage value. Aaron's Office Furniture store depreciates merchandise over its estimated useful life, which ranges from 24 months to 48 months, net of salvage value, which ranges from 0% to 30%. The Company's policies require weekly lease merchandise counts by store managers, which include write-offs for unsalable, damaged, or missing merchandise inventories. Full physical inventories are generally taken at the fulfillment and manufacturing facilities two to four

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

times a year, and appropriate provisions are made for missing, damaged and unsalable merchandise. In addition, the Company monitors lease merchandise levels and mix by division, store, and fulfillment center, as well as the average age of merchandise on hand. If unsalable lease merchandise cannot be returned to vendors, it is adjusted to its net realizable value or written off.

All lease merchandise is available for lease or sale. On a monthly basis, all damaged, lost or unsalable merchandise identified is written off. The Company records lease merchandise adjustments on the allowance method. Lease merchandise write-offs totaled \$46.2 million, \$46.5 million, and \$38.3 million during the years ended December 31, 2011, 2010 and 2009, respectively, and are included in operating expenses in the accompanying consolidated statements of earnings. Included in 2010 is a write-down of \$4.7 million related to the closure of stores of the Aaron's Office Furniture division.

**DISPOSAL ACTIVITIES**—The Company began ceasing the operations of the Aaron's Office Furniture division in June of 2010. The Company closed 14 of its Aaron's Office Furniture stores during 2010 and has one remaining store open to liquidate merchandise. As a result, in 2010 the Company recorded \$3.3 million in closed store reserves, \$4.7 million in lease merchandise write-downs and other miscellaneous expenses, respectively, totaling \$9.0 million. The charges were recorded within operating expenses on the consolidated statement of earnings and are included in the Other segment category. There were no charges related to the closure of this division in 2011.

**CASH AND CASH EQUIVALENTS**—The Company classifies as cash highly liquid investments with maturity dates of less than three months when purchased.

**INVESTMENT SECURITIES**—The amortized cost, gross unrealized gains and losses, and fair value of investment securities held to maturity at December 31, 2011 are as follows. The securities are recorded at amortized cost in the consolidated balance sheets and mature at various dates during 2012 and 2013. There were no investment securities held by the Company at December 31, 2010.

(In Thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate Bonds	\$82,243	\$15	\$(664)	\$81,594
Perfect Home Bonds	15,889	—	—	15,889
	\$98,132	\$15	\$(664)	\$97,483

The amortized cost and fair value of held to maturity securities at December 31, 2011, by contractual maturity are as follows:

(In Thousands)	Amortized Cost	Fair Value
Due in one year or less	\$60,403	\$60,093
Due in years one through two	37,729	37,390
Ending Balance	\$98,132	\$97,483

Information pertaining to held to maturity securities with gross unrealized losses at December 31, 2011 are as follows. All of the securities have been in a continuous loss position for less than 12 months.

(In Thousands)	Gross Fair Value	Unrealized Losses
Corporate Bonds	\$72,315	\$(664)

The Company evaluates securities for other-than-temporary impairment on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. The Company does not intend to sell the securities and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases.

The unrealized losses at December 31, 2011 relate principally to the increases in short-term market interest rates that occurred since the securities were purchased and 38 of the 44 securities are in an unrealized loss position as of December 31, 2011. The fair value is expected to recover as the securities approach their maturity or if market yields for such investments decline. In analyzing an issuer's financial condition, management considers whether downgrades by bond rating agencies have occurred. The Company has the intent and ability to hold the investment securities until their amortized cost basis is recovered on the maturity date. As a result of management's analysis and review, no declines are deemed to be other than temporary.

**ACCOUNTS RECEIVABLE**—The Company maintains an allowance for doubtful accounts. The reserve for returns is calculated based on the historical collection experience associated with lease receivables. The Company's policy is to write off lease receivables that are 60 days or more past due.

The following is a summary of the Company's allowance for doubtful accounts as of December 31:

(In Thousands)	2011	2010	2009
Beginning Balance	\$ 4,544	\$ 4,157	\$ 4,040
Accounts written off	(25,178)	(23,601)	(20,352)
Bad debt expense	25,402	23,988	20,469
Ending Balance	\$ 4,768	\$ 4,544	\$ 4,157

**PROPERTY, PLANT AND EQUIPMENT**—The Company records property, plant and equipment at cost. Depreciation and amortization are computed on a straight-line basis over the estimated useful lives of the respective assets, which are from five to 40 years for buildings and improvements and from one to fifteen years for other depreciable property and equipment. Gains and losses related to dispositions and retirements are recognized as incurred.

Maintenance and repairs are also expensed as incurred; renewals and betterments are capitalized. Depreciation expense, included in operating expenses in the accompanying consolidated statements of earnings, for property, plant and equipment was \$45.2 million, \$41.4 million and \$40.7 million during the years ended December 31, 2011, 2010 and 2009, respectively.

**ASSETS HELD FOR SALE**—Certain properties, primarily consisting of parcels of land, met the held for sale classification criteria at December 31, 2011 and 2010. After adjustment to fair value, the \$9.9 million and \$11.8 million carrying value of these properties has been classified as assets held for sale in the consolidated balance sheets as of December 31, 2011 and 2010, respectively. The Company estimated the fair values of these properties using market values for similar properties and these are considered Level 2 assets as defined in FASB ASC Topic 820, *Fair Value Measurements*.

#### **GOODWILL AND OTHER INTANGIBLES WITH INDEFINITE**

**LIVES**—Goodwill and intangibles with indefinite lives represent the excess of the purchase price paid over the fair value of the identifiable net tangible and intangible assets acquired in connection with business acquisitions. Impairment occurs when the carrying value of goodwill and intangibles with indefinite lives is not recoverable from future cash flows. The Company performs an assessment of goodwill and intangibles with indefinite lives for impairment at the reporting unit level annually as of September 30, or when events or circumstances indicate that impairment may have occurred. Factors which could necessitate an interim impairment assessment include a sustained decline in the Company's stock price, prolonged negative industry or economic trends and significant underperformance relative to expected historical or projected future operating results. The Company tests goodwill and intangibles with indefinite lives at the operating segment level as operations (stores) included in each operating segment have similar economic characteristics.

Fair value of reporting units used in the goodwill and intangibles with indefinite lives impairment test is determined based on either a multiple of gross revenue or other appropriate fair value methods. If the carrying value of the reporting unit exceeds the fair value, a second analysis is performed to measure the fair value of all assets and liabilities. If, based on the second analysis, it is determined that the fair value of the assets and liabilities is less than the carrying value, an impairment charge in an amount equal to the excess of the carrying value over fair value would be recognized. During the performance of the annual assessment of goodwill and intangibles with indefinite useful lives for impairment in the 2011, 2010 and 2009 fiscal years, the Company did not identify any reporting units which had estimated fair values that were not substantially in excess of their carrying values other than the HomeSmart division for which locations were recently acquired.

**OTHER INTANGIBLES**—Other intangibles represent the value of customer relationships acquired in connection with business acquisitions, acquired franchise development rights and non-compete agreements, recorded at fair value as determined by the Company. As of December 31, 2011 and 2010, the net intangibles other than good-

will were \$4.0 million and \$3.8 million, respectively for the Sales and Lease Ownership segment, and \$2.0 million for the HomeSmart segment at December 31, 2011. The customer relationship intangible is amortized on a straight-line basis over a two-year useful life. Acquired franchise development rights are amortized over the unexpired life of the franchisee's ten year area development agreement. The non-compete intangible is amortized on a straight-line basis over a three-year useful life. Amortization expense of intangibles for the Sales and Lease Ownership segment, included in operating expenses in the accompanying consolidated statements of earnings, was \$2.0 million, \$3.1 million and \$3.8 million during the years ended December 31, 2011, 2010 and 2009, respectively. Amortization expense of intangibles for the HomeSmart segment, included in operating expenses in the accompanying consolidated statements of earnings, was \$312,000 during the year ended December 31, 2011.

The following is a summary of the Company's goodwill in its Sales and Lease Ownership segment at December 31:

(In Thousands)	2011	2010
Beginning Balance	\$202,379	\$194,376
Additions	5,468	9,240
Disposals	(2,338)	(1,237)
Ending Balance	\$205,509	\$202,379

The following is a summary of the Company's goodwill in its HomeSmart segment at December 31:

(In Thousands)	2011
Beginning Balance	\$ —
Additions	13,833
Disposals	—
Ending Balance	\$ 13,833

**IMPAIRMENT**—The Company assesses its long-lived assets other than goodwill for impairment whenever facts and circumstances indicate that the carrying amount may not be fully recoverable. When it is determined that the carrying values of the assets are not recoverable, the Company compares the carrying values of the assets to their fair values as estimated using discounted expected future cash flows, market values or replacement values for similar assets. The amount by which the carrying value exceeds the fair value of the asset is recognized as an impairment loss.

The Company also recorded impairment charges of \$453,000 and \$879,000 within operating expenses in 2011 and 2010, respectively, both of which related primarily to the impairment of various land outparcels and buildings included in its Sales and Lease Ownership segment that the Company decided not to utilize for future expansion. The assets held for sale are included in the Other segment.

The Company performed an impairment analysis on the Aaron's Office Furniture long-lived assets in the third quarter of 2009 due to continuing negative performance. As a result, the

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Company recorded an impairment charge of \$1.3 million in 2009 within operating expenses related primarily to the impairment of leasehold improvements in the Aaron's Office Furniture stores. The Aaron's Office Furniture long-lived assets are Level 2 assets. In addition, the Company recorded an \$865,000 write-down to certain office furniture lease merchandise in 2009 within operating expenses. The impairment charge and inventory write-down are included in the Other segment.

**DERIVATIVE FINANCIAL INSTRUMENTS**—The Company utilizes derivative financial instruments to mitigate its exposure to certain market risks associated with its ongoing operations for a portion of the year. The primary risk it seeks to manage through the use of derivative financial instruments is commodity price risk, including the risk of increases in the market price of diesel fuel used in the Company's delivery vehicles. All derivative financial instruments are recorded at fair value on the consolidated balance sheets. The Company does not use derivative financial instruments for trading or speculative purposes. The Company is exposed to counterparty credit risk on all its derivative financial instruments. The counterparties to these contracts are high credit quality commercial banks, which the Company believes largely minimize the risk of counterparty default. The fair values of the Company's fuel hedges as of December 31, 2010 and the changes in their fair values in 2011 and 2010 were immaterial. The Company did not hold any derivative financial instruments as of December 31, 2011.

**FAIR VALUE OF FINANCIAL INSTRUMENTS**—The fair values of the Company's cash and cash equivalents, accounts receivable and accounts payable approximate their carrying amounts due to their short-term nature.

At December 31, 2011 and 2010, the fair value of fixed rate long-term debt approximated its carrying value. The fair value of debt is estimated using valuation techniques that consider risk-free borrowing rates and credit risk.

**DEFERRED INCOME TAXES**—Deferred income taxes represent primarily temporary differences between the amounts of assets and liabilities for financial and tax reporting purposes. The Company's largest temporary differences arise principally from the use of accelerated depreciation methods on lease merchandise for tax purposes.

**REVENUE RECOGNITION**—Lease revenues are recognized as revenue in the month they are due. Lease payments received prior to the month due are recorded as deferred lease revenue. Until all payments are received under sales and lease ownership agreements, the Company maintains ownership of the lease merchandise. Revenues from the sale of merchandise to franchisees are recognized at the time of receipt of the merchandise by the franchisee, and revenues from such sales to other customers are recognized at the time of shipment, at which time title and risk of ownership are transferred to the customer. Refer to Note I for discussion of recognition of other

franchise-related revenues. The Company presents sales net of sales taxes.

**RETAIL AND NON-RETAIL COST OF SALES**—Included in cost of sales is the net book value of merchandise sold, primarily using specific identification. It is not practicable to allocate operating expenses between selling and lease operations.

**SHIPPING AND HANDLING COSTS**—The Company classifies shipping and handling costs as operating expenses in the accompanying consolidated statements of earnings, and these costs totaled \$68.1 million in 2011, \$60.6 million in 2010 and \$55.0 million in 2009.

**ADVERTISING**—The Company expenses advertising costs as incurred. Advertising costs are recorded as expenses the first time an advertisement appears. Such costs aggregated to \$38.9 million in 2011, \$31.7 million in 2010 and \$31.0 million in 2009. These advertising expenses are shown net of cooperative advertising considerations received from vendors, substantially all of which represents reimbursement of specific, identifiable and incremental costs incurred in selling those vendors' products. The amount of cooperative advertising consideration netted against advertising expense was \$25.4 million in 2011, \$27.2 million in 2010 and \$23.4 million in 2009. The prepaid advertising asset was \$1.6 million and \$3.2 million at December 31, 2011 and 2010, respectively.

**STOCK-BASED COMPENSATION**—The Company has stock-based employee compensation plans, which are more fully described in Note H below. The Company estimates the fair value for the options granted on the grant date using a Black-Scholes option-pricing model and accounts for stock-based compensation under the fair value recognition provisions codified in FASB ASC Topic 718, Stock Compensation. The fair value of each share of restricted stock awarded was equal to the market value of a share of the Company's Common Stock on the grant date.

**INSURANCE RESERVES**—Estimated insurance reserves are accrued primarily for group health, general liability, automobile liability and workers compensation benefits provided to the Company's employees. Estimates for these insurance reserves are made based on actual reported but unpaid claims and actuarial analyses of the projected claims run off for both reported and incurred but not reported claims.

**COMPREHENSIVE INCOME**—For the years ended December 31, 2011, 2010 and 2009, comprehensive income totaled \$113.2 million, \$119.3 million and \$113.9 million, respectively.

**FOREIGN CURRENCY TRANSLATION**—Assets and liabilities denominated in a foreign currency are translated into U.S. dollars at the current rate of exchange on the last day of the reporting period. Revenues and expenses are generally translated at a daily exchange rate and equity transactions are translated using the actual rate on the day of the transaction.





## NOTE B: EARNINGS PER SHARE

Earnings per share is computed by dividing net earnings by the weighted average number of shares of Common Stock outstanding during the period. The computation of earnings per share assuming dilution includes the dilutive effect of stock options, restricted stock units (“RSUs”) and restricted stock awards (“RSAs”). Stock options had the effect of increasing the weighted average shares outstanding assuming dilution by approximately 998,000 in 2011, 745,000 in 2010, and 663,000 in 2009. RSUs had the effect of increasing the weighted average shares outstanding assuming dilution by approximately 236,000, and 25,000 for the years ending 2011, and 2010, respectively. There were no RSUs that had the effect of increasing the weighted average shares outstanding assuming dilution for the year ended December 31, 2009. RSAs had the effect of increasing the weighted average shares outstanding assuming dilution by 3,000 in 2011, 138,000 in 2010 and 150,000 in 2009.

There were no anti-dilutive stock options excluded from the computation of earnings per share assuming dilution for the twelve months ended December 31, 2011. Anti-dilutive stock options excluded from the computation of earnings per share assuming dilution were 314,000 and 470,000 for the twelve months ended December 31, 2010 and 2009, respectively. Anti-dilutive RSUs and RSAs excluded from the computation of earnings per share assuming dilution were 298,000, 275,000 and 45,000 in 2011, 2010 and 2009, respectively.



## NOTE C: PROPERTY, PLANT AND EQUIPMENT

Following is a summary of the Company’s property, plant, and equipment at December 31:

(In Thousands)	2011	2010
Land	\$ 25,882	\$ 25,067
Buildings and Improvements	81,566	74,216
Leasehold Improvements and Signs	116,632	100,031
Fixtures and Equipment	133,615	109,458
Assets Under Capital Leases:		
with Related Parties	7,641	8,501
with Unrelated Parties	10,564	10,564
Construction in Progress	5,444	9,485
	381,344	337,322
Less: Accumulated Depreciation and Amortization	(154,725)	(132,410)
	\$226,619	\$204,912

Amortization expense on assets recorded under capital leases is included in operating expenses and was \$1.2 million, \$1.9 million

and \$1.2 million in 2011, 2010 and 2009, respectively. Capital leases consist of buildings and improvements. Assets under capital leases with related parties included \$4.2 million and \$4.0 million in accumulated depreciation and amortization as of December 31, 2011 and 2010, respectively. Assets under capital leases with unrelated parties included \$3.8 million and \$3.2 million in accumulated depreciation and amortization as of December 31, 2011 and 2010, respectively.



## NOTE D: CREDIT FACILITIES

Following is a summary of the Company’s credit facilities at December 31:

(In Thousands)	2011	2010
Senior Unsecured Notes	\$137,000	\$24,000
Capital Lease Obligation:		
with Related Parties	6,730	7,279
with Unrelated Parties	6,809	7,208
Other Debt	3,250	3,303
	\$153,789	\$41,790

**BANK DEBT** — On May 18, 2011, the Company entered into the second amendment to its revolving credit agreement, dated May 23, 2008, as amended, and on July 1, 2011, the Company entered into a third amendment. The amendments to the revolving credit agreement (i) add the defined terms “Institutional Investor” and “Private Placement Debt” to further clarify the circumstances under which the Company may incur indebtedness and still remain in compliance with applicable negative covenants and (ii) modified the negative covenant restricting debt applicable to the Company by, among other things, increasing the amount of indebtedness the Company may incur with respect to certain privately placed debt from an aggregate principal amount of up to \$60.0 million to an aggregate principal amount of up to \$150.0 million. The Company entered into the amendments in order to permit the issuance of the 3.75% unsecured senior notes issued to a consortium of insurance companies as described below.

The Company has a revolving credit agreement with several banks providing for unsecured borrowings up to \$140.0 million. Amounts borrowed bear interest at the lower of the lender’s prime rate or LIBOR plus 87.5 basis points. The pricing under a working capital line is based upon overnight bank borrowing rates. At December 31, 2011 and 2010, there was a zero balance under the Company’s revolving credit agreement. The Company pays a .20% commitment fee on unused balances. The weighted average interest rate on borrowings under the revolving credit agreement was 0.97% in 2011, 0.97% in 2010 and 1.23% in 2009. The revolving credit agreement expires May 23, 2013.

The revolving credit agreement contains financial covenants which, among other things, prohibit the Company from exceeding

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

certain debt to equity levels and require the maintenance of minimum fixed charge coverage ratios. If the Company fails to comply with these covenants, the Company will be in default under these agreements, and all amounts could become due immediately. At December 31, 2011, \$140.1 million of retained earnings was available for dividend payments and stock repurchases under the debt restrictions, and the Company was in compliance with all covenants.

**SENIOR UNSECURED NOTES**—On July 5, 2011, the Company entered into a note purchase agreement with several insurance companies. Pursuant to this agreement, the Company and its subsidiary, Aaron Investment Company, as co-obligors issued \$125.0 million in senior unsecured notes to the purchasers in a private placement. The notes bear interest at the rate of 3.75% per year and mature on April 27, 2018. Payments of interest are due quarterly, commencing July 27, 2011, with principal payments of \$25.0 million each due annually commencing April 27, 2014. The new note purchase agreement contains financial maintenance covenants, negative covenants regarding the Company's other indebtedness, its guarantees and investments, and other customary covenants substantially similar to the covenants in the Company's existing note purchase agreement, revolving credit facility and franchisee loan and guaranty facility, as modified.

On July 27, 2005, the Company sold \$60.0 million in aggregate principal amount of senior unsecured notes in a private placement to a consortium of insurance companies. The notes bear interest at a rate of 5.03% per year and mature on July 27, 2012. Interest-only payments were due quarterly for the first two years, followed by annual \$12.0 million principal repayments plus interest for the five years thereafter. The related note purchase agreement contains financial maintenance covenants, negative covenants regarding the Company's other indebtedness, its guarantees and investments and other customary covenants substantially similar to the covenants in the Company's revolving credit facility. At December 31, 2011 and 2010, there was \$12.0 million and \$24.0 million outstanding under the July 2005 senior unsecured notes, respectively.

**CAPITAL LEASES WITH RELATED PARTIES**—In October and November 2004, the Company sold 11 properties, including leasehold improvements, to a limited liability company ("LLC") controlled by a group of Company executives, including the Company's Chairman. The LLC obtained borrowings collateralized by the land and buildings totaling \$6.8 million. The Company occupies the land and buildings collateralizing the borrowings under a 15-year term lease, with a five-year renewal at the Company's option, at an aggregate annual rental of \$716,000. The transaction has been accounted for as a financing in the accompanying consolidated financial statements. The rate of interest implicit in the leases is approximately 9.7%. Accordingly, the land and buildings, associated depreciation expense and lease obligations are recorded in the Company's consolidated financial statements. No gain or loss was recognized in this transaction.

In December 2002, the Company sold ten properties, including leasehold improvements, to the LLC. The LLC obtained borrowings collateralized by the land and buildings totaling \$5.0 million.

The Company occupies the land and buildings collateralizing the borrowings under a 15-year term lease at an aggregate annual rental of approximately \$556,000. The transaction has been accounted for as a financing in the accompanying consolidated financial statements. The rate of interest implicit in the leases is approximately 11.1%. Accordingly, the land and buildings, associated depreciation expense and lease obligations are recorded in the Company's consolidated financial statements. No gain or loss was recognized in this transaction.

**SALE-LEASEBACKS**—The Company finances a portion of store expansion through sale-leaseback transactions. The properties are generally sold at net book value and the resulting leases qualify and are accounted for as operating leases. The Company does not have any retained or contingent interests in the stores nor does the Company provide any guarantees, other than a corporate level guarantee of lease payments, in connection with the sale-leasebacks.

**OTHER DEBT**—Other debt at December 31, 2011 and 2010 includes \$3.3 million of industrial development corporation revenue bonds. The weighted-average borrowing rate on these bonds in 2011 was 0.38%. No principal payments are due on the bonds until maturity in 2015.

Future maturities under the Company's long-term debt and capital lease obligations are as follows:

(In Thousands)	
2012	\$ 19,258
2013	6,886
2014	31,833
2015	35,145
2016	31,756
Thereafter	65,184
	<u>\$190,062</u>



## NOTE E: INCOME TAXES

Following is a summary of the Company's income tax expense for the years ended December 31:

(In Thousands)	2011	2010	2009
Current Income Tax Expense:			
Federal	\$ —	\$ —	\$40,697
State	9,797	8,932	7,832
	<u>9,797</u>	<u>8,932</u>	<u>48,529</u>
Deferred Income Tax Expense (Benefit):			
Federal	62,015	64,679	15,169
State	(2,202)	(1,201)	(137)
	<u>59,813</u>	<u>63,478</u>	<u>15,032</u>
	<u>\$69,610</u>	<u>\$72,410</u>	<u>\$63,561</u>

At December 31, 2011, the Company had a federal net operating loss (“NOL”) carryforward of approximately \$31.2 million available to offset future taxable income. The NOLs expire in 2030 and 2031 and utilization is subject to applicable annual limitations for U.S. federal and U.S. state tax purposes, including Section 382 of the Internal Revenue Code of 1986, as amended. The Company intends to carryforward the NOLs to offset future taxable income and does not anticipate that the utilization will be impacted by the applicable limitations.

As a result of the bonus depreciation provisions in the 2010 tax acts the Company paid more than it’s anticipated 2010 federal tax liability. The 2010 acts provided an estimated tax deferral of approximately \$127.0 million. The Company filed for a refund of overpaid federal tax of approximately \$80.9 million in January 2011 and received that refund in February 2011.

Significant components of the Company’s deferred income tax liabilities and assets at December 31 are as follows:

(In Thousands)	2011	2010
Deferred Tax Liabilities:		
Lease Merchandise and Property, Plant and Equipment	\$329,497	\$248,775
Other, Net	29,607	24,777
Total Deferred Tax Liabilities	359,104	273,552
Deferred Tax Assets:		
Accrued Liabilities	33,826	15,859
Advance Payments	16,432	15,231
Federal Net Operating Loss	10,936	6,423
Other, Net	11,760	9,386
Total Deferred Tax Assets	72,954	46,899
Less Valuation Allowance	(812)	(860)
Net Deferred Tax Liabilities	\$286,962	\$227,513

The Company’s effective tax rate differs from the statutory United States Federal income tax rate for the years ended December 31 as follows:

	2011	2010	2009
Statutory Rate	35.0%	35.0%	35.0%
Increases (Decreases) in United States Federal Taxes Resulting From:			
State Income Taxes, Net of Federal Income Tax Benefit	2.7	2.7	2.8
Other, Net	0.3	0.3	(1.8)
Effective Tax Rate	38.0%	38.0%	36.0%

The Company files a federal consolidated income tax return in the United States and the separate legal entities file in various states and foreign jurisdictions. With few exceptions, the Company is no longer subject to federal, state and local tax examinations by tax

authorities for years before 2008. The lower effective tax rate in 2009 was due to the favorable impact of a \$2.3 million reversal of previously recorded liabilities for uncertain tax positions.

The following table summarizes the activity related to the Company’s uncertain tax positions:

(In Thousands)	2011	2010	2009
Balance at January 1,	\$1,315	\$1,342	\$3,110
Additions based on tax positions related to the current year	178	149	172
Additions for tax positions of prior years	22	18	523
Prior year reductions	(13)	(26)	(46)
Statute expirations	(90)	(63)	(2,231)
Settlements	—	(105)	(186)
Balance at December 31,	\$1,412	\$1,315	\$1,342

As of December 31, 2011 and 2010, the amount of uncertain tax benefits that, if recognized, would affect the effective tax rate is \$1.2 million and \$1.3 million, respectively, including interest and penalties. During the years ended December 31, 2011, 2010 and 2009, the Company recognized interest and penalties of \$41,000, \$35,000, and \$276,000, respectively. The Company had \$374,000 and \$332,000 of accrued interest and penalties at December 31, 2011 and 2010, respectively. The Company recognizes potential interest and penalties related to uncertain tax benefits as a component of income tax expense.



## NOTE F: COMMITMENTS AND CONTINGENCIES

### Leases

The Company leases warehouse and retail store space for most of its operations under operating leases expiring at various times through 2028. The Company also leases certain properties under capital leases that are more fully described in Note D. Most of the leases contain renewal options for additional periods ranging from one to 20 years or provide for options to purchase the related property at predetermined purchase prices that do not represent bargain purchase options. In addition, certain properties occupied under operating leases contain normal purchase options. Leasehold improvements related to these leases are generally amortized over periods that do not exceed the lesser of the lease term or 15 years. While a majority of leases do not require escalating payments, for the leases which do contain such provisions the Company records the related lease expense on a straight-line basis over the lease term. The Company also leases transportation and computer equipment under operating leases expiring during the next five years. Management expects that most leases will be renewed or replaced by other leases in the normal course of business.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Future minimum lease payments required under operating leases that have initial or remaining non-cancelable terms in excess of one year as of December 31, 2011, are as follows:

(In Thousands)

2012	\$100,906
2013	87,393
2014	72,205
2015	56,252
2016	40,217
Thereafter	174,322
	<u>\$531,295</u>

Rental expense was \$93.6 million in 2011, \$96.1 million in 2010, and \$88.1 million in 2009. The amount of sublease income is \$3.1 million in 2011, \$2.8 million in 2010, and \$1.5 million in 2009. The Company has anticipated future sublease rental income of \$4.7 million in 2012, \$3.7 million in 2013, \$3.0 million in 2014, \$2.6 million in 2015, \$2.1 million in 2016 and \$8.8 million thereafter through 2024. Rental expense and sublease income are included in operating expenses.

## Guarantees

The Company has guaranteed certain debt obligations of some of the franchisees amounting to \$128.8 million and \$121.0 million at December 31, 2011 and 2010, respectively. Of this amount, approximately \$108.5 million represents franchise borrowings outstanding under the franchise loan program and approximately \$20.3 million represents franchise borrowings under other debt facilities at December 31, 2011. The Company receives guarantee fees based on such franchisees' outstanding debt obligations, which it recognizes as the guarantee obligation is satisfied. The Company has recourse rights to the assets securing the debt obligations, which consist primarily of lease merchandise inventory and fixed assets. As a result, the Company has never incurred any, nor does management expect to incur, any significant losses under these guarantees. On May 18, 2011, the Company entered into a second amendment to its second amended and restated loan facility and guaranty, dated June 18, 2010, as amended, and on July 1, 2011, the Company entered into a third amendment. The amendments to the franchisee loan facility, among other things, (i) extend the maturity date until May 16, 2012, (ii) increase the maximum Canadian subfacility commitment amount for loans to franchisees that operate stores in Canada (other than in the Province of Quebec) from Cdn \$25.0 million to Cdn \$35.0 million, (iii) add the defined terms "Institutional Investor" and "Private Placement Debt" to further clarify the circumstances under which the Company may incur indebtedness and still remain in compliance with applicable negative covenants, (iv) modify the negative covenant restricting debt applicable to the Company by, among other things, increasing the amount of indebtedness the Company may incur with respect to certain privately placed debt from an aggregate principal amount of up to \$60.0 million to an aggregate principal amount of up to \$150.0 million, and (v) replace

the pricing grid schedule to the franchisee loan facility to reduce the applicable margins and participant unused commitment fee percentages with respect to the funded participations.

## Legal Proceedings

The Company is frequently a party to various legal proceedings arising in the ordinary course of business. Management regularly assesses the Company's insurance deductibles, analyzes litigation information with the Company's attorneys and evaluates its loss experience to determine whether or not any legal proceedings may have an adverse impact upon the Company's business. The Company accrues for litigation loss contingencies that are both probable and reasonably estimable. Legal fees and expenses associated with the defense of all of the Company's litigation are expensed as such fees and expenses are incurred. While the Company does not presently believe that any of the legal proceedings to which the Company are currently a party will ultimately have a material adverse impact upon our business, financial position or results of operations, there can be no assurance that we will prevail in all the proceedings we are party to, or that the Company will not incur material losses from them. Some of the proceedings the Company is currently a party to are described below:

In *Kunstmann et al v. Aaron Rents, Inc.*, originally filed with the United States District Court, Northern District of Alabama, on October 29, 2008, plaintiffs alleged that the Company improperly classified store general managers as exempt from the overtime provisions of the Fair Labor Standards Act. Plaintiffs seek to recover unpaid overtime compensation and other damages for all similarly situated general managers nationwide for the period January 25, 2007 to present. After initially denying plaintiffs' class certification motion in April 2009, the court ruled to conditionally certify a plaintiff class in early 2010. The current class includes 247 individuals. The Company has filed its motion to decertify the class action as well as a motion for summary judgment on plaintiffs' individual claims.

In *Alford v. Aaron Rents, Inc. et al* originally filed in the U.S. District Court for the Southern District of Illinois on October 2, 2008, plaintiff alleged, among other claims, that she was sexually harassed and subjected to retaliation, in violation of Title VII of the Civil Rights Act of 1964, by a general manager of a Company store. After trial, the jury returned a defense verdict solely on the claim of retaliation. On June 14, 2011, the jury awarded plaintiff compensatory damages in the amount of \$13.5 million and punitive damages in the amount of \$80.0 million. Of the total damages awarded, \$53.7 million exceeded the maximum award permitted by law. Consequently, the court reduced the judgment to \$39.8 million. The Company filed motions to reduce the verdict and/or for a new trial and was required to post a bond in the amount of \$5.0 million while judgment was stayed pending post-trial motions. On January 13, 2012, the court ruled that the verdict would not be sustained in its current form and the Company is waiting for a detailed ruling from the court regarding whether it will order a new trial on liability and/or damages or reduce the jury's damages award beyond the reduction previously described.

The Company has accrued \$41.5 million, which represents



the judgment, as reduced, and associated legal fees and expenses and has insurance coverage of \$5.0 million for this litigation. Additional positive or negative developments in the lawsuit could affect the assumptions, and therefore, the accrual.

In *Margaret Korrow, et al. v. Aaron's Inc.*, originally filed in the Superior Court of New Jersey, Middlesex County, Law Division on October 26, 2010, plaintiff filed suit on behalf of herself and others similarly situated alleging that Company is liable in damages to plaintiff and each class member because the Company's lease agreements issued after March 16, 2006 purportedly violated certain New Jersey state consumer statutes. The Company removed the lawsuit to the United States District Court for the District of New Jersey on December 6, 2010. Discovery is proceeding and no class has yet been certified.

In *Crystal and Brian Byrd v. Aaron's, Inc., Aspen Way Enterprises, Inc., John Does (1-100) Aaron's Franchisees and Designerware, LLC.*, filed on May 16, 2011 in the United States District Court, Western District of Pennsylvania, plaintiffs allege that the Company and its franchisees knowingly violated plaintiffs' and other similarly situated plaintiffs' privacy in violation of the Electronic Communications Privacy Act and the Computer Fraud Abuse Act through its use of a software program called "PC Rental Agent." The Company expressly denies that any of its Company-operated stores engaged in the alleged conduct and intends to defend itself vigorously. On February 17, 2012, the Magistrate Judge recommended in her report to the district court that the Company be dismissed from the lawsuit. It is expected that the district court will issue a final ruling based upon this recommendation in the second quarter of 2012. It is possible that the court may permit plaintiffs to file an amended complaint. The Company has received inquiries from government agencies requesting information regarding this lawsuit and another incident involving the compromise of customer information, and inquiring about, among other things, the Company's retail transactional, information security and privacy policies and practices.

The Company believes it has meritorious defenses to the claims described above, and intends to vigorously defend itself against the claims. However, due to inherent uncertainty in litigation and similar adversarial proceedings, there can be no guarantee that the Company will ultimately be successful in these proceedings, or in others to which it is currently a party. Substantial losses from legal proceedings or the costs of defending them could have a material adverse impact upon the Company's business, financial position or results of operations.

Accrued litigation expense was \$41.7 million and \$1.7 million at December 31, 2011 and 2010, respectively. The Company believes this reserve was adequate at December 31, 2011, and is adequate currently, but future developments in pending legal proceedings can affect the required reserve. We do not currently believe that the reasonably possible aggregate range of loss for our pending litigation will exceed the amount we have currently accrued for litigation expense by any material amount, although this belief is subject to the uncertainties and variables described above. We continually monitor our litigation exposure, and review

the adequacy of our legal reserves on a quarterly basis in accordance with applicable accounting rules.

## Other Commitments

At December 31, 2011, the Company had non-cancelable commitments primarily related to certain advertising and marketing programs of \$38.7 million. Payments under these commitments are scheduled to be \$19.5 million in 2012, \$17.3 million in 2013, and \$1.9 million in 2014.

The Company maintains a 401(k) savings plan for all its full-time employees with at least one year of service and who meet certain eligibility requirements. The plan allows employees to contribute up to 100% of their annual compensation in accordance with federal contribution limits with 50% matching by the Company on the first 4% of compensation. The Company's expense related to the plan was \$891,000 in 2011, \$841,000 in 2010, and \$844,000 in 2009.

The Company is a party to various claims and legal proceedings arising in the ordinary course of business. Management regularly assesses the Company's insurance deductibles, analyzes litigation information with the Company's attorneys and evaluates its loss experience. The Company also enters into various contracts in the normal course of business that may subject it to risk of financial loss if counterparties fail to perform their contractual obligations.



## NOTE G: SHAREHOLDERS' EQUITY

The Company held 15,111,635 shares in its treasury and was authorized to purchase an additional 5,281,344 shares at December 31, 2011. The Company repurchased 5,075,675 shares of its Common Stock on the open market in 2011 and 1,478,805 shares of its former Nonvoting Common Stock on the open market in 2010. The Company did not repurchase any shares of its capital stock in 2009.

The Company has 1,000,000 shares of preferred stock authorized. The shares are issuable in series with terms for each series fixed by the Board and such issuance is subject to approval by the Board of Directors. As of December 31, 2011, no preferred shares have been issued.



## NOTE H: STOCK OPTIONS AND RESTRICTED STOCK

The Company's outstanding stock options are exercisable for its Common Stock. The Company estimates the fair value for the options on the grant date using a Black-Scholes option-pricing model. The expected volatility is based on the historical volatility of the Company's Common Stock over the most recent period generally commensurate with the expected estimated life of each respective grant. The expected lives of options are based on the Company's historical option exercise experience. Forfeiture assumptions are based on the Company's historical forfeiture experience. The Company

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

believes that the historical experience method is the best estimate of future exercise and forfeiture patterns. The risk-free interest rates are determined using the implied yield available for zero-coupon United States government issues with a remaining term equal to the expected life of the grant. The expected dividend yields are based on the approved annual dividend rate in effect and market price of the underlying Common Stock at the time of grant. No assumption for a future dividend rate increase has been included unless there is an approved plan to increase the dividend in the near term. Shares are issued from the Company's treasury shares upon share option exercises.

Under the Aaron's Management Performance Plan ("AMP Plan") RSUs are granted quarterly upon achievement of certain pre-tax profit levels during the prior quarter by the employees' operating units or the overall Company. The RSUs granted under the AMP Plan vest over four to five years from the date of grant. The AMP Plan participants include certain vice presidents, director level employees and other key personnel in the Company's home office, divisional vice presidents and regional managers.

The results of operations for the years ended December 31, 2011, 2010 and 2009 include \$2.6 million, \$3.2 million and \$2.4 million, respectively, in compensation expense related to unvested grants. At December 31, 2011, there was \$2.7 million of total unrecognized compensation expense related to non-vested stock options which is expected to be recognized over a period of 2.2 years. Excess tax benefits of \$1.3 million, \$321,000 and \$3.9 million are included in cash provided by financing activities for the years ended December 31, 2011, 2010 and 2009, respectively. The Company recognizes compensation cost for awards with graded

vesting on a straight-line basis over the requisite service period for each separately vesting portion of the award.

Under the Company's stock option plans, options granted to date become exercisable after a period of two to five years and unexercised options lapse ten years after the date of the grant. Options are subject to forfeiture upon termination of service. The aggregate number of shares of common stock that may be issued or transferred under the incentive stock awards plan is 14,700,556 at December 31, 2011.

The Company granted 347,000 stock options during 2010. The Company did not grant any stock options in 2011 and 2009. The weighted average fair value of options granted was \$10.31 in 2010. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions for 2010, respectively: risk-free interest rate 3.59%; a dividend yield of .25%; a volatility factor of the expected market price of the Company's Common Stock of .41; weighted average assumptions of forfeiture rate of 3.89%; and weighted average expected life of the option of nine years. The aggregate intrinsic value of options exercised was \$5.5 million, \$848,000 and \$13.1 million in 2011, 2010 and 2009, respectively. The total fair value of options vested was \$2.7 million and \$3.2 million in 2011 and 2010, respectively.

Income tax benefits resulting from stock option exercises credited to additional paid-in capital totaled \$2.1 million, \$1.4 million, and \$4.8 million, in 2011, 2010 and 2009, respectively.

The following table summarizes information about stock options outstanding at December 31, 2011:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding December 31, 2011	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise price	Number Exercisable December 31, 2011	Weighted Average Exercise Price
\$ 5.92–10.00	460,661	1.62	\$ 8.80	460,661	\$ 8.80
10.01–15.00	2,068,006	5.19	13.97	1,281,506	13.89
15.01–19.92	320,453	7.84	19.70	21,203	16.61
\$ 5.92–19.92	2,849,120	4.91	\$13.78	1,763,370	\$12.59

The table below summarizes option activity for the periods indicated in the Company's stock option plans:

	Options (In Thousands)	Weighted Average	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (In Thousands)	Weighted Average Fair Value
Outstanding at January 1, 2011	3,374	\$13.80		\$43,460	\$6.26
Granted	—	—		—	—
Exercised	(447)	13.68		(5,469)	5.45
Forfeited	(78)	15.21		(886)	6.18
Outstanding at December 31, 2011	2,849	13.78	4.91 years	36,760	6.38
Exercisable at December 31, 2011	1,763	\$12.59	3.52 years	\$24,848	\$5.93

The weighted average fair value of unvested options was \$7.12, \$6.66 and \$6.08 as of December 31, 2011, 2010 and 2009, respectively. The weighted average fair value of options that vested during 2011, 2010 and 2009 was \$5.93, \$5.87 and \$5.35, respectively.

The Company granted 246,000 and 300,000 RSUs in 2011 and 2010, respectively, and there were no RSUs granted in 2009. The Company granted 20,000 RSAs in 2011. The Company did not grant RSAs in 2010 and 2009. Of the 246,000 RSUs granted in 2011, 225,000 were related to executive grants and 21,000 were granted as part of the AMP Plan. The weighted average grant date fair value for RSUs not part of the AMP plan was \$23.08 in 2011 and \$16.20 in 2010. The weighted average grant date fair value for RSUs granted as part of the AMP plan was \$26.19 in 2011. The weighted average grant date fair value for RSAs was \$26.34 in 2011.

Shares of restricted stock or restricted stock units may be granted to employees and directors and typically vest over approximately two to five year periods. Restricted stock grants may be subject to one or more objective employment, performance or other forfeiture conditions as established at the time of grant. Any shares of restricted stock that are forfeited may again become available for issuance. Compensation cost for restricted stock is equal to the fair market value of the shares at the date of the award and is amortized to compensation expense over the vesting period. Total compensation expense related to restricted stock was \$5.7 million, \$1.5 million and \$1.3 million in 2011, 2010 and 2009, respectively. At December 31, 2011, there was \$5.4 million of total unrecognized compensation expense related to non-vested restricted stock which is expected to be recognized over a period of 2.4 years.

During the year 287,000 restricted shares vested, 150,000 of these shares were restricted stock units attributed to an immediate vest modification related to the separation for a key executive, 137,000 of these shares were restricted stock awards granted in 2006. The total value of shares vesting during the year was \$4.0 million for restricted stock units and \$3.2 million for restricted stock awards. There were no shares vested under the AMP Plan.

During 2011, the Company recorded a \$3.5 million charge for separation costs primarily related to the accelerated vesting of the aforementioned 150,000 restricted stock units and 50,000 stock option previously granted to a former key executive. The total incremental compensation cost resulting from the modification was \$1.3 million.

The following table summarizes information about restricted stock activity:

	Restricted Stock (In Thousands)	Weighted Average Grant Price
Outstanding at January 1, 2011	438	\$17.01
Granted	266	23.57
Vested	(287)	25.24
Forfeited	(2)	22.84
Outstanding at December 31, 2011	415	\$19.64



## NOTE I: FRANCHISING OF AARON'S SALES AND LEASE OWNERSHIP STORES

The Company franchises Aaron's Sales & Lease Ownership stores. As of December 31, 2011 and 2010, 943 and 946 franchises had been granted, respectively. Franchisees typically pay a non-refundable initial franchise fee from \$15,000 to \$50,000 depending upon market size and an ongoing royalty of either 5% or 6% of gross revenues. Franchise fees and area development fees are generated from the sale of rights to develop, own and operate Aaron's Sales & Lease Ownership stores. These fees are recognized as income when substantially all of the Company's obligations per location are satisfied, generally at the date of the store opening. Franchise fees and area development fees are received before the substantial completion of the Company's obligations and deferred. Substantially all of the amounts reported as non-retail sales and non-retail cost of sales in the accompanying consolidated statements of earnings relate to the sale of lease merchandise to franchisees.

Franchise agreement fee revenue was \$2.6 million, \$3.0 million and \$3.8 million and royalty revenue was \$52.0 million, \$47.9 million and \$42.3 million for the years ended December 31, 2011, 2010 and 2009, respectively. Deferred franchise and area development agreement fees, included in customer deposits and advance payments in the accompanying consolidated balance sheets, were \$4.7 million and \$5.5 million at December 31, 2011 and 2010, respectively.

Franchised Aaron's Sales & Lease Ownership store activity is summarized as follows:

(Unaudited)	2011	2010	2009
Franchised stores open at January 1	664	597	504
Opened	55	62	84
Added through acquisition	—	10	—
Purchased from the Company	9	10	37
Purchased by the Company	(7)	(12)	(19)
Closed, sold or merged	(8)	(3)	(9)
Franchised stores open at December 31,	713	664	597

Company-operated Aaron's Sales & Lease Ownership store activity is summarized as follows:

(Unaudited)	2011	2010	2009
Company-operated stores open at January 1,	1,146	1,082	1,037
Opened	57	86	85
Added through acquisition	8	14	19
Closed, sold or merged	(51)	(36)	(59)
Company-operated stores open at December 31,	1,160	1,146	1,082

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Company-operated HomeSmart store activity is summarized as follows:

(Unaudited)	2011	2010
Company-operated stores open at January 1,	3	—
Opened	24	3
Added through acquisition	44	—
Company-operated stores open at December 31,	71	3

In 2011, Sales and Lease Ownership segment acquired the lease contracts, merchandise and other related assets of 38 stores, including seven franchised stores, and merged certain acquired stores into existing stores, resulting in a net gain of eight stores. In 2010, the Company acquired the lease contracts, merchandise and other related assets of 30 stores, including 12 franchised stores, and merged certain acquired stores into existing stores, resulting in a net gain of 14 stores. In 2009, the Company acquired the lease contracts, merchandise and other related assets of 44 stores, including 19 franchised stores, and merged certain acquired stores into existing stores, resulting in a net gain of 29 stores.

In 2011, HomeSmart operations acquired the lease contracts, merchandise and other related assets of 47 stores and merged certain acquired stores into existing stores, resulting in a net gain of 44 stores.



## NOTE J: ACQUISITIONS AND DISPOSITIONS

During 2011, the Company acquired the lease contracts, merchandise and related assets of a net of 52 sales and lease ownership stores for an aggregate purchase price of \$41.4 million. Consideration transferred consisted primarily of cash. Fair value of acquired tangible assets included \$13.4 million for lease merchandise, \$500,000 for fixed assets, and \$21,000 for other assets. The excess cost over the fair value of the assets and liabilities acquired in 2011, representing goodwill, was \$22.9 million. The fair value of acquired separately identifiable intangible assets included \$2.7 million for customer lists, \$1.7 million for non-compete intangibles, and \$255,000 for acquired franchise development rights. The weighted average amortization period for these intangibles was 2.5 years.

During 2010, the Company acquired the lease contracts, merchandise and other related assets of a net of 14 sales and lease ownership stores for an aggregate purchase price of \$17.9 million. Consideration transferred consisted primarily of cash. Fair value of acquired tangible assets included \$6.5 million for lease merchandise, \$333,000 for fixed assets and \$34,000 for other assets. The excess cost over the fair value of the assets and liabilities acquired in 2010, representing goodwill, was \$9.2 million. The fair value of acquired separately identifiable intangible assets included \$748,000

for customer lists, \$541,000 for non-compete intangibles and \$496,000 for acquired franchise development rights. The weighted average amortization period for these intangibles was 2.7 years.

During 2009, the Company acquired the lease contracts, merchandise and other related assets of a net of 29 sales and lease ownership stores for an aggregate purchase price of \$25.2 million. Consideration transferred consisted primarily of cash. Fair value of acquired tangible assets included \$9.5 million for lease merchandise, \$712,000 for fixed assets and \$28,000 for other assets. The excess cost over the fair value of the assets and liabilities acquired in 2010, representing goodwill, was \$12.0 million. The fair value of acquired separately identifiable intangible assets included \$1.1 million for customer lists, \$695,000 for non-compete intangibles and \$477,000 for acquired franchise development rights. The weighted average amortization period for these intangibles was 2.4 years.

Acquisitions have been accounted for as business combinations, and the results of operations of the acquired businesses are included in the Company's results of operations from their dates of acquisition. The effect of these acquisitions on the 2011, 2010 and 2009 consolidated financial statements was not significant. The estimated amortization of sales and lease ownership stores customer lists, reacquired franchise development rights and non-compete intangibles in future years approximates \$916,000, \$728,000, \$191,000, \$34,000 and \$32,000 for 2012, 2013, 2014, 2015 and 2016, respectively. The estimated amortization of HomeSmart customer lists and non-compete intangibles in future years approximates \$1.0 million, \$826,000, and \$202,000 for 2012, 2013, and 2014, respectively. All goodwill acquired in 2011, 2010 and 2009 is expected to be deductible for tax purposes.

The following is a summary of the Aaron's Sales & Lease Ownership Company-operated stores' intangible assets by category at December 31:

(In Thousands)	2011	2010	2009
Customer Relationship Intangible, Gross	\$3,698	\$6,675	\$8,267
Accumulated Amortization on Customer Relationship Intangible	(1,827)	(5,719)	(6,406)
Reacquired Franchise Intangible, Gross	1,227	2,814	3,561
Accumulated Amortization on Re-acquired Franchise Rights	(307)	(862)	(938)
Non-Compete Intangible, Gross	2,133	1,402	861
Accumulated Amortization on Non-Compete Intangible	(906)	(478)	(145)

The Company periodically sells sales and lease ownership stores to franchisees and third party operators. The Company sold 25, 11 and 37 of its Aaron's Sales and Lease Ownership stores in 2011, 2010 and 2009, respectively. The effect of these sales on the consolidated financial statements was not significant.



The following is a summary of the HomeSmart stores' intangible assets by category at December 31:

(In Thousands)	2011
Customer Relationship Intangible, Gross	\$1,402
Accumulated Amortization on Customer Relationship Intangible	(194)
Reacquired Franchise Intangible, Gross	—
Accumulated Amortization on Re-acquired Franchise Rights	—
Non-Compete Intangible, Gross	957
Accumulated Amortization on Non-Compete Intangible	(117)

The Company did not sell any of its HomeSmart stores in 2011.



## NOTE K: SEGMENTS

### Description of Products and Services of Reportable Segments

Aaron's, Inc. has four reportable segments: Sales and Lease Ownership, Franchise, HomeSmart and Manufacturing. In all periods presented, HomeSmart was reclassified from the Other Segment to the HomeSmart segment. During 2008, the Company sold its corporate furnishings division. The Aaron's Sales & Lease Ownership division offers electronics, residential furniture, appliances and computers to consumers primarily on a monthly payment basis with no credit requirements. The HomeSmart division offers electronics, residential furniture, appliances and computers to consumers primarily on a weekly payment basis with no credit requirements. The Company's franchise operation sells and supports franchisees of its sales and lease ownership concept. The Manufacturing segment manufactures upholstered furniture and bedding predominantly for use by Company-operated and franchised stores. Therefore the Manufacturing Segment revenues and earnings before income taxes are solely the result of intercompany transactions and are eliminated through the Elimination of Intersegment Revenues. The Company has elected to aggregate certain operating segments.

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:

- Sales and lease ownership revenues are reported on the cash basis for management reporting purposes.
- A predetermined amount of each reportable segment's revenues is charged to the reportable segment as an allocation of corporate overhead. This allocation was approximately 2% in 2011, 2010 and 2009.
- Accruals related to store closures are not recorded on the reportable segments' financial statements, but are rather maintained and controlled by corporate headquarters.

- The capitalization and amortization of manufacturing variances are recorded on the consolidated financial statements as part of Cash to Accrual and Other Adjustments and are not allocated to the segment that holds the related lease merchandise.
- Advertising expense in the Sales and Lease Ownership and HomeSmart segments is estimated at the beginning of each year and then allocated to the division ratably over time for management reporting purposes. For financial reporting purposes, advertising expense is recognized when the related advertising activities occur. The difference between these two methods is reflected as part of the Cash to Accrual and Other Adjustments line below.
- Sales and lease ownership lease merchandise write-offs are recorded using the direct write-off method for management reporting purposes and using the allowance method for financial reporting purposes. The difference between these two methods is reflected as part of the Cash to Accrual and Other Adjustments line below.
- Interest on borrowings is estimated at the beginning of each year. Interest is then allocated to operating segments based on relative total assets.

Revenues in the "Other" category are primarily revenues of the Aaron's Office Furniture division, from leasing space to unrelated third parties in the corporate headquarters building and revenues from several minor unrelated activities. The pre-tax losses in the "Other" category are the net result of the activity mentioned above, net of the portion of corporate overhead not allocated to the reportable segments for management purposes.

### Measurement of Segment Profit or Loss and Segment Assets

The Company evaluates performance and allocates resources based on revenue growth and pre-tax profit or loss from operations. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies except that the sales and lease ownership division revenues and certain other items are presented on a cash basis. Intersegment sales are completed at internally negotiated amounts. Since the intersegment profit and loss affect inventory valuation, depreciation and cost of goods sold are adjusted when intersegment profit is eliminated in consolidation.

### Factors Used by Management to Identify the Reportable Segments

The Company's reportable segments are based on the operations of the Company that the chief operating decision maker regularly reviews to analyze performance and allocate resources among business units of the Company.

Included in the Earnings Before Income Taxes results above for the Sales and Lease Ownership segment is a \$36.5 million charge for the lawsuit expense described in Note F. As discussed in Note N, the Company sold substantially all of the assets of the Aaron's Corporate Furnishings division during the fourth quarter of 2008. For financial reporting purposes, this division has been classified as a discontinued operation and is not included in our segment information as shown below.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Information on segments and a reconciliation to earnings before income taxes from continuing operations are as follows:

(In Thousands)	Year Ended December 31, 2011	Year Ended December 31, 2010	Year Ended December 31, 2009
<b>REVENUES FROM EXTERNAL CUSTOMERS:</b>			
Sales and Lease Ownership	\$1,938,991	\$1,803,778	\$1,685,841
Franchise	63,255	59,112	52,941
HomeSmart	15,624	56	—
Manufacturing	89,430	79,115	72,473
Other	9,960	16,458	19,320
Revenues of Reportable Segments	2,117,260	1,958,519	1,830,575
Elimination of Intersegment Revenues	(89,953)	(80,109)	(73,184)
Cash to Accrual Adjustments	(3,258)	(1,563)	(4,604)
Total Revenues from External Customers	\$2,024,049	\$1,876,847	\$1,752,787
<b>EARNINGS BEFORE INCOME TAXES:</b>			
Sales and Lease Ownership	\$143,686	\$159,417	\$147,261
Franchise	49,577	45,935	39,335
HomeSmart	(7,283)	(318)	—
Manufacturing	2,960	3,216	3,329
Other	(141)	(7,847)	(5,676)
Earnings Before Income Taxes for Reportable Segments	188,799	200,403	184,249
Elimination of Intersegment Profit	(2,959)	(3,218)	(3,341)
Cash to Accrual and Other Adjustments	(2,463)	(6,399)	(4,469)
Total Earnings Before Income Taxes From Continuing Operations	\$183,377	\$190,786	\$176,439
<b>ASSETS:</b>			
Sales and Lease Ownership	\$1,293,151	\$1,248,785	\$1,110,675
Franchise	56,131	55,789	51,245
HomeSmart	50,600	955	—
Manufacturing	11,142	14,723	15,512
Other	324,125	181,820	144,024
Total Assets	\$1,735,149	\$1,502,072	\$1,321,456
<b>DEPRECIATION AND AMORTIZATION:</b>			
Sales and Lease Ownership	\$588,036	\$539,669	\$508,218
Franchise	41	41	192
HomeSmart	5,933	21	—
Manufacturing	1,294	2,958	1,888
Other	8,260	6,843	9,073
Total Depreciation and Amortization	\$603,564	\$549,532	\$519,371
<b>INTEREST EXPENSE:</b>			
Sales and Lease Ownership	\$4,473	\$2,937	\$4,030
Franchise	—	—	—
HomeSmart	201	2	—
Manufacturing	142	15	15
Other	(107)	142	254
Total Interest Expense	\$4,709	\$3,096	\$4,299
<b>CAPITAL EXPENDITURES:</b>			
Sales and Lease Ownership	\$53,502	\$73,166	\$76,151
HomeSmart	11,349	202	—
Manufacturing	6,521	6,584	1,474
Other	11,752	9,118	6,338
Total Capital Expenditures from Continuing Operations	\$83,124	\$89,070	\$83,963
Revenues From Canadian Operations (included in totals above):			
Sales and Lease Ownership	\$3,258	\$4,470	\$3,781
Assets From Canadian Operations (included in totals above):			
Sales and Lease Ownership	\$1,527	\$15,093	\$6,469



## NOTE L: RELATED PARTY TRANSACTIONS

The Company leases certain properties under capital leases with certain related parties that are more fully described in Note D above.

In the fourth quarter of 2011, the Company purchased an airplane for \$2.8 million and sold it to R. Charles Loudermilk, Sr., Chairman of the Board of Directors of the Company, for the same amount. The Company paid approximately \$80,000 in brokerage fees in connection with the transaction, for which Mr. Loudermilk reimbursed the Company. In the fourth quarter of 2011, the Company transferred a Company-owned vehicle to Mr. Loudermilk valued at \$21,000.

In 2009, the Company sponsored the son of its Chief Operating Officer as a driver for the Robert Richardson Racing team in the NASCAR Nationwide Series at a cost of \$1.6 million. The Company also paid \$22,000 for team decals, apparel and driver travel to corporate promotional events. The sponsorship agreement expired at the end of the year and was not renewed. Motor sports promotions and sponsorships are an integral part of the Company's marketing programs.

In the second quarter of 2009, the Company entered into an agreement with R. Charles Loudermilk, Sr. to exchange 750,000 of Mr. Loudermilk, Sr.'s shares of the Company's former Class A Common Stock for 624,503 shares of its former Nonvoting Common Stock having approximately the same fair market value, based on a 30 trading day average.



## NOTE M: QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

(In Thousands, Except Per Share)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
<b>YEAR ENDED DECEMBER 31, 2011</b>				
Revenues	\$532,665	\$482,700	\$485,195	\$523,489
Gross Profit*	259,542	236,958	231,942	242,163
Earnings Before Taxes From Continuing Operations	71,919	17,627	45,092	48,739
Net Earnings	44,389	10,799	28,045	30,534
Earnings Per Share	.55	.14	.36	.40
Earnings Per Share Assuming Dilution	.55	.13	.36	.40
<b>YEAR ENDED DECEMBER 31, 2010</b>				
Revenues	\$495,269	\$444,999	\$452,150	\$484,429
Gross Profit*	239,827	215,725	217,994	226,822
Earnings Before Taxes From Continuing Operations	59,562	39,329	42,085	49,810
Net Earnings	36,975	24,435	26,179	30,787
Earnings Per Share	.45	.30	.32	.38
Earnings Per Share Assuming Dilution	.45	.30	.32	.38

\* Gross profit is the sum of lease revenues and fees, retail sales, and non-retail sales less retail cost of sales, non-retail cost of sales, depreciation of lease merchandise and write-offs of lease merchandise.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS



## NOTE N: DISCONTINUED OPERATIONS

On September 12, 2008, the Company entered into an agreement with CORT Business Services Corporation to sell substantially all of the assets of its Aaron's Corporate Furnishings division and to transfer certain of the Aaron's Corporate Furnishings division's liabilities to CORT. The Aaron's Corporate Furnishings division, which operated 47 stores, primarily engaged in the business of leasing and selling residential furniture, electronics, appliances, housewares and accessories. The Company consummated the sale of the Aaron's Corporate Furnishings division in the fourth quarter of 2008.

Summarized operating results for the Aaron's Corporate Furnishings division for the years ended December 31 are as follows:

(In Thousands)	2011	2010	2009
Loss Before Income Taxes	—	—	\$(447)
Loss From Discontinued Operations, Net of Tax	—	—	(277)



## NOTE O: DEFERRED COMPENSATION PLAN

Effective July 1, 2009, the Company implemented the Aaron's, Inc. Deferred Compensation Plan (the "Plan") an unfunded, nonqualified deferred compensation plan for a select group of management, highly compensated employees and non-employee directors. On a pre-tax basis, eligible employees can defer receipt of up to 75% of their base compensation and up to 100% of their incentive pay compensation, and eligible non-employee directors can defer receipt of up to 100% of both their cash and stock director fees. In addition, the Company elected to make restoration matching contributions on behalf of eligible employees to compensate for certain limitations on the amount of matching contributions an employee can receive under the Company's tax-qualified 401(k) plan.

Compensation deferred under the Plan is credited to each participant's deferral account and a deferred compensation liability is recorded in accounts payable and accrued expenses in the consolidated balance sheets. The deferred compensation plan liability was approximately \$6.3 million and \$3.5 million as of December 31, 2011 and 2010, respectively. Liabilities under the Plan are recorded at amounts due to participants, based on the fair value of participants' selected investments. The Company has established a Rabbi Trust to fund obligations under the Plan with Company-owned life insurance. The obligations are unsecured general obligations of

the Company and the participants have no right, interest or claim in the assets of the Company, except as unsecured general creditors. The cash surrender value of these policies totaled \$5.8 million and \$3.5 million as of December 31, 2011 and 2010, respectively, and is included in prepaid expenses and other assets in the consolidated balance sheets.

Deferred compensation expense charged to operations for the Company's matching contributions totaled \$306,000, \$231,000 and \$130,000 in 2011, 2010, and 2009 respectively. Benefits of \$77,000 have been paid as of December 31, 2011. No benefits were paid in 2010.



## NOTE P: VARIABLE INTEREST ENTITIES

On October 14, 2011, the Company purchased 11.5% of the common stock of Perfect Home Holdings Limited ("Perfect Home"), a privately-held rent-to-own company that is primarily financed by subordinated debt. Perfect Home is based in the United Kingdom and operates over 40 retail stores. As part of the transaction, the Company also received notes and an option to acquire the remaining interest in Perfect Home at any time through December 31, 2013. If the Company does not exercise the option prior to December 31, 2013, it will be obligated to sell the common stock and notes back to Perfect Home at the original purchase price plus interest. The Company's investment is denominated in British Pounds.

Perfect Home is a VIE as it does not have sufficient equity at risk; however, the Company is not the primary beneficiary and lacks the power through voting or similar rights to direct those activities of Perfect Home that most significantly affect its economic performance. As such, the VIE is not consolidated by the Company.

Because the Company is not able to exercise significant influence over the operating and financial decisions of Perfect Home, the equity portion of the investment in Perfect Home totaling less than a thousand dollars at December 31, 2011 is accounted for as a cost method investment and is included in prepaid expenses and other assets. The notes purchased from Perfect Home totaling \$15.9 million at December 31, 2011 are accounted for as held to maturity securities in accordance with ASC 320, *Debt and Equity Securities* and are included in investment securities. Utilizing a Black-Scholes model, the options to buy the remaining interest in Perfect Home and to sell the Company's interest in Perfect Home were determined to have only nominal values. The Company recorded aggregate transaction losses related to the investment of \$228,000 to expense during the year ended December 31, 2011. The Company's maximum exposure to any potential losses associated with this VIE is equal to its total recorded investment which totals \$15.9 million at December 31, 2011.



# MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management of Aaron's, Inc. and subsidiaries (the "Company") is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate. Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial report-

ing. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, the risk.

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2011. In making this assessment, the Company's management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework.

Based on its assessment, management believes that, as of December 31, 2011, the Company's internal control over financial reporting was effective based on those criteria.

The Company's internal control over financial reporting as of December 31, 2011 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report dated February 29, 2012, which expresses an unqualified opinion on the effectiveness of the Company's internal control over financial reporting as of December 31, 2011.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON FINANCIAL STATEMENTS

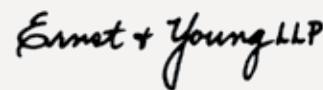
### The Board of Directors of Aaron's, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Aaron's, Inc. and subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of earnings, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2011. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Aaron's, Inc. and subsidiaries at December 31, 2011 and 2010, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Aaron's, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 29, 2012 expressed an unqualified opinion thereon.



Atlanta, Georgia  
February 29, 2012

# REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON INTERNAL CONTROL OVER FINANCIAL REPORTING

## The Board of Directors of Aaron's, Inc. and Subsidiaries

We have audited Aaron's, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Aaron's, Inc. and subsidiaries' management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately

and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Aaron's, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Aaron's, Inc. and subsidiaries as of December 31, 2011 and 2010 and the related consolidated statements of earnings, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2011 of Aaron's, Inc. and subsidiaries and our report dated February 29, 2012 expressed an unqualified opinion thereon.

Atlanta, Georgia  
February 29, 2012

*Ernst + Young LLP*

# MARKET INFORMATION, HOLDERS AND DIVIDENDS

Effective December 13, 2010, all shares of the Common Stock began trading as a single class on the New York Stock Exchange under the ticker symbol "AAN." The CUSIP number of the Common Stock is 002535300.

The number of shareholders of record of the Company's Common Stock at February 22, 2012 was 270. The closing price for the Common Stock at February 22, 2012 was \$27.97.

The following table shows the range of high and low closing prices per share for the Company's former Nonvoting Common Stock and Company's former Class A Common Stock (now known as the Common Stock) and the quarterly cash dividends declared per share for the periods indicated.

Common Stock	High	Low	Cash Dividends Per Share
<b>DECEMBER 31, 2011</b>			
First Quarter	\$25.52	\$19.16	\$.013
Second Quarter	29.29	24.79	.013
Third Quarter	29.34	22.17	.013
Fourth Quarter	29.10	23.24	.015
<b>DECEMBER 31, 2010</b>			
Fourth Quarter (December 13, 2010–December 31, 2010) <sup>1</sup>	\$20.67	\$19.73	\$.013

Former Nonvoting Common Stock	High	Low	Cash Dividends Per Share
<b>DECEMBER 31, 2010</b>			
First Quarter <sup>2</sup>	\$ 22.47	\$ 18.25	\$.012
Second Quarter <sup>2</sup>	24.32	17.05	.012
Third Quarter	18.62	16.16	.012
Fourth Quarter (October 1, 2010–December 10, 2010) <sup>1</sup>	22.53	16.92	NA

Former Class A Common Stock	High	Low	Cash Dividends Per Share
<b>DECEMBER 31, 2010</b>			
First Quarter <sup>2</sup>	\$18.10	\$14.60	\$.012
Second Quarter <sup>2</sup>	19.85	13.55	.012
Third Quarter	18.40	13.00	.012
Fourth Quarter (October 1, 2010–December 10, 2010) <sup>1</sup>	21.03	16.81	NA

(1) Effective December 13, 2010 shares of the former Nonvoting Common Stock were converted into shares of Class A Common Stock and the Class A Common Stock was renamed Common Stock.

(2) Shares have been adjusted for the effect of the 3-for-2 partial stock split distributed on April 15, 2010 and effective April 16, 2010.

Subject to our ongoing ability to generate sufficient income, any future capital needs and other contingencies, we expect to continue our policy of paying quarterly dividends. Under our revolving credit agreement, we may pay cash dividends in any year only if the dividends do not exceed 50% of our consolidated net earnings for the prior fiscal year plus the excess, if any, of the cash dividend limitation applicable to the prior year over the dividend actually paid in the prior year.

## Issuer Purchases of Equity Securities

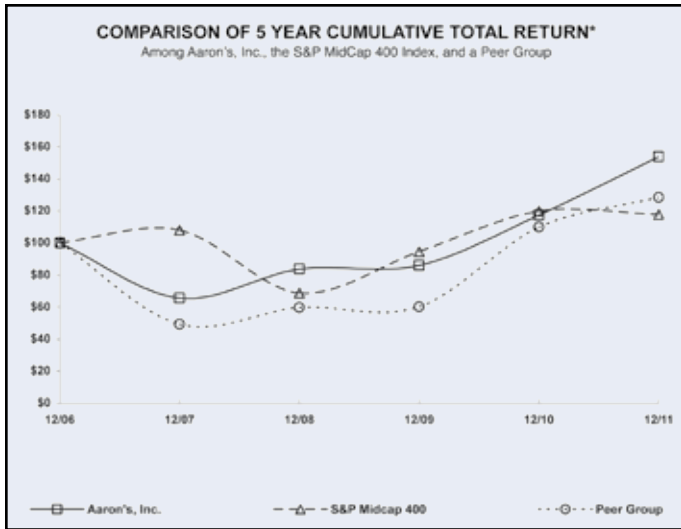
The Company repurchased 5,075,675 shares of Common Stock during 2011 at an average price of \$25.06 under our publicly-announced share repurchase program for repurchase at the discretion of the Chief Financial Officer. As of December 31, 2011, 5,281,344 Common Stock shares remained available for repurchase under the purchase authority approved by the Company's Board of Directors and publicly announced from time-to-time.

The following table provides information regarding our Common Stock repurchases. All repurchases were made on the open market.

Period	Issuer Purchases of Equity Securities			(d) Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs
	(a) Total Number of Common Stock Purchased	(b) Average Price Paid Per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	
October 1 through October 31, 2011	—	—	—	5,281,344
November 1 through November 30, 2011	—	—	—	5,281,344
December 1 through December 31, 2011	—	—	—	5,281,344
QTD Total	—	—	—	

Information concerning the Company's equity compensation plans is set forth in Item 12 of Part III of our Annual Report on Form 10-K for the year ended December 31, 2011 filed with the SEC.

# MARKET INFORMATION, HOLDERS AND DIVIDENDS



\*\$100 invested on 12/31/06 in stock or index, including reinvestment of dividends.

Fiscal year ending December 31.

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The line graph above and the table below compare, for the last five fiscal years of the Company, the yearly percentage change in the cumulative total shareholder returns (assuming reinvestment of dividends) on the Company's Common Stock with that of the S&P MidCap 400 Index and a Peer Group. For 2011, the Peer Group consisted of Rent-A-Center, Inc. The stock price performance shown is not necessarily indicative of future performance.

	12/06	12/07	12/08	12/09	12/10	12/11
Aaron's, Inc.	100.00	65.61	83.69	86.06	117.34	153.87
S&P MidCap 400	100.00	107.98	68.86	94.60	119.80	117.72
Peer Group	100.00	49.20	59.81	60.05	109.95	128.42

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# BOARD OF DIRECTORS AND OFFICERS

## BOARD OF DIRECTORS

**R. Charles Loudermilk, Sr.**  
Chairman of the Board, Aaron's, Inc.

**Ronald W. Allen**  
President and Chief Executive Officer,  
Aaron's, Inc.

**Leo Benatar**<sup>(1, 3, 4)</sup>  
Principal, Benatar & Associates

**William K. Butler, Jr.**  
Chief Operating Officer, Aaron's, Inc.

**Gilbert L. Danielson**  
Executive Vice President, Chief  
Financial Officer, Aaron's, Inc.

**David L. Kolb**<sup>(2, 4)</sup>  
Retired Chairman and Chief Executive  
Officer, Mohawk Industries, Inc.

**Ray M. Robinson**<sup>(3, 4)</sup>  
President Emeritus, East Lake Golf  
Club and Vice Chairman, East Lake  
Community Foundation

**John Schuerholz**<sup>(2, 3)</sup>  
President, The Atlanta Braves

**Cynthia N. Day**<sup>(2)</sup>  
President and Chief Executive Officer  
Citizens Trust Bank

### Director Emeritus

**Earl Dolive**  
Vice Chairman of the Board, Emeritus,  
Genuine Parts Company

## OFFICERS

### Corporate

**R. Charles Loudermilk, Sr.\***  
Chairman of the Board

**Ronald W. Allen\***  
President, Chief Executive Officer

**William K. Butler, Jr.\***  
Chief Operating Officer

**Gilbert L. Danielson\***  
Executive Vice President,  
Chief Financial Officer

**James L. Cates\***  
Senior Group Vice President,  
Corporate Secretary

**Jeannie M. Cave**  
Vice President, Real Estate and Construction

**Elizabeth L. Gibbs\***  
Vice President, General Counsel

**John T. Trainor\***  
Vice President,  
Chief Information Officer

**Michael W. Jarnagin**  
Vice President, Manufacturing

**James C. Johnson**  
Vice President, Internal Audit

**Robert P. Sinclair, Jr.\***  
Vice President, Corporate Controller

**D. Chad Strickland**  
Vice President, Associate Resources

**Danny Walker, Sr.**  
Vice President, Internal Security

### Aaron's Sales & Lease Ownership Division

**K. Todd Evans\***  
Vice President, Franchising

**Mitchell S. Paull\***  
Senior Vice President,  
Merchandising and Logistics

**Gregory G. Bellof**  
Vice President, Mid-Atlantic Operations

**Michael C. Bennett**  
Vice President, Great Lakes Operations

**David A. Boggan**  
Vice President, Mississippi  
Valley Operations

**David L. Buck**  
Vice President, Southwestern Operations

**Todd G. Coppedge**  
Vice President, Midwest Operations

**Joseph N. Fedorchak**  
Vice President, Eastern Operations

**Scott L. Harvey**  
Vice President, Management Development

**Kevin J. Hrvatin**  
Vice President, Western Operations

**Jason M. McFarland**  
Vice President, Mid-American Operations

**Steven A. Michaels**  
Vice President, Finance

**Tristan J. Montanero**  
Vice President, Central Operations

**Brock M. Roberts**  
Vice President, Northeastern Operations

**Michael P. Ryan**  
Vice President, Northern Operations

**Thomas A. Peterson**  
Vice President, Marketing

### HomeSmart Division

**Marco A. Scalise**  
Vice President, HomeSmart Operations

**Mark A. Rudnick**  
Vice President, Marketing,  
HomeSmart/RIMCO

### Aaron's Office Furniture Division

**Ronald M. Bedit**  
Vice President, Operations

(1) Lead Director

(2) Member of Audit Committee

(3) Member of Compensation Committee

(4) Member of Nominating Committee

\* Executive Officer

# CORPORATE AND SHAREHOLDER INFORMATION

## Corporate Headquarters

309 E. Paces Ferry Rd., N.E.  
Atlanta, Georgia 30305-2377  
(404) 231-0011  
www.aarons.com  
www.aaronsinc.com

## Subsidiaries

**Aaron Investment Company**  
4005 Kennett Pike  
Greenville, Delaware 19807  
(302) 888-2351

**Aaron's Canada, ULC**  
309 E. Paces Ferry Rd., N.E.  
Atlanta, Georgia 30305-2377  
(404) 231-0011

**Aaron's Foundation, Inc.**  
309 E. Paces Ferry Rd., N.E.  
Atlanta, Georgia 30305-2377  
(404) 231-0011

**99LTO, LLC**  
309 E. Paces Ferry Rd., N.E.  
Atlanta, Georgia 30305-2377  
(404) 231-0011

## Annual Shareholders Meeting

The annual meeting of the shareholders of Aaron's, Inc. will be held on Tuesday, May 1, 2012, at 10:00 a.m. EDT on the 4th Floor, SunTrust Plaza, 303 Peachtree Street, N.E., Atlanta, Georgia 30303

**Transfer Agent and Registrar**  
Computershare Investor Services  
Canton, Massachusetts

**SEC Counsel**  
Kilpatrick Townsend & Stockton LLP  
Atlanta, Georgia

## Form 10-K

Shareholders may obtain a copy of the Company's annual report on Form 10-K filed with the Securities and Exchange Commission upon written request, without charge. Such requests should be sent to the attention of Gilbert L. Danielson, Executive Vice President, Chief Financial Officer, Aaron's, Inc., 309 E. Paces Ferry Rd., N.E., Atlanta, Georgia 30305-2377.

## Stock Listing

Aaron's, Inc.'s Common Stock is traded on the New York Stock Exchange under the symbol "AAN."

## Forward-Looking Statements

Certain written and oral statements made by our Company may constitute "forward-looking statements" as defined under the Private Securities Litigation Reform Act of 1995, including statements made in this report and in the Company's filings with the Securities and Exchange Commission. Forward-looking statements are based on management's current beliefs, assumptions and expectations regarding our future economic performance, taking into account the information currently available to management. Generally, the words "anticipate," "believe," "estimate," "expect," "intend," "project," and similar expressions identify forward-looking statements, which generally are not historical in nature. All statements which address operating performance, events, or developments that we expect or anticipate will occur in the future—including growth in store openings, franchises awarded, and market share, and statements expressing general optimism about future operating results—are forward-looking statements. Forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from the Company's historical experience and the Company's present expectations or projections. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, changes in assumptions or otherwise. For a discussion of such risks and uncertainties, see "Risk Factors" in Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2011 filed with the Securities and Exchange Commission.



*Aaron's, Inc.*

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