

AAR Corp. (AIR)

\$38.02 (As of 03/04/20)

Price Target (6-12 Months): **\$40.00**

Long Term: 6-12 Months

Zacks Recommendation:
Neutral

(Since: 11/29/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:A

Value: A

Growth: B

Momentum: B

Summary

AAR Corp's strategic investments toward its parts supply activities have enabled the company to capitalize on steady parts demand. It also continues to witness strong performance in its parts supply and program activities. In fact, solid sales from its parts supply activities have been one of the primary catalysts behind its top-line growth. Banking on these initiatives, management expects to witness continued growth in its parts supply business in the days ahead. However, it continues to witness labor shortages in its MRO business and the issue is expected to linger in the near term. Moreover, its shares underperformed its industry in past year. U.S. Department of Justice's investigation on its Airlift business segment has forced the company to divest this asset. This divestment may impact its operating results, going ahead.

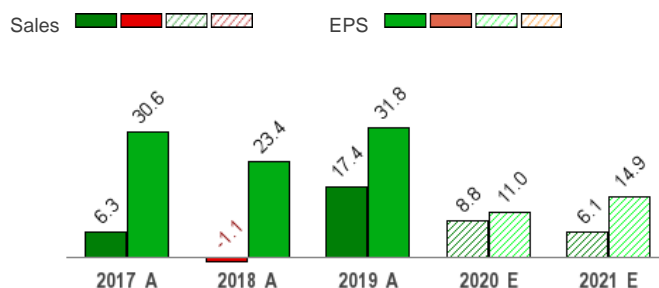
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$52.78 - \$29.84
20 Day Average Volume (sh)	175,170
Market Cap	\$1.3 B
YTD Price Change	-15.7%
Beta	1.33
Dividend / Div Yld	\$0.30 / 0.8%
Industry	Aerospace - Defense Equipment
Zacks Industry Rank	Bottom 33% (172 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	4.9%
Last Sales Surprise	6.1%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	03/17/2020
Earnings ESP	0.0%
P/E TTM	14.4
P/E F1	14.5
PEG F1	NA
P/S TTM	0.6

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					2,369 E
2020	542 A	561 A	558 E	567 E	2,233 E
2019	466 A	493 A	530 A	563 A	2,052 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.72 E	\$0.80 E	\$0.76 E	\$0.83 E	\$3.01 E
2020	\$0.57 A	\$0.64 A	\$0.66 E	\$0.74 E	\$2.62 E
2019	\$0.54 A	\$0.59 A	\$0.79 A	\$0.64 A	\$2.36 A

*Quarterly figures may not add up to annual.

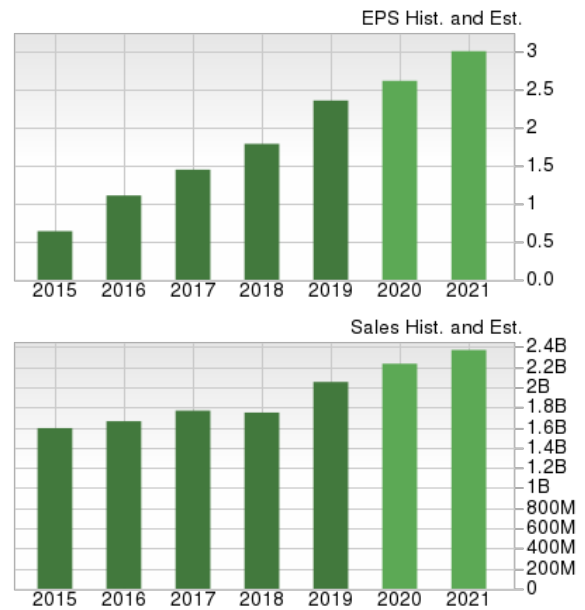
The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 03/04/2020. The reports text is as of 03/05/2020.

Overview

Wood Dale, IL-based AAR Corp., incorporated in the year 1951, provides various products and services to the aviation and defense industries worldwide. Its principal customers include The Boeing Company and Airbus. The company now reports through two business segments – **Aviation Services** and **Expeditionary Services** – following the divestiture of Telair Cargo Group and the planned sale of Precision Systems Manufacturing.

The *Aviation Services* segment comprises supply chain maintenance, repair and overhaul (MRO) activities. This segment provides aftermarket support and services for the commercial aviation and government and defense markets. It provides inventory management and distribution services, overhaul, repair and engineering services. Segment sales in fiscal 2019 were \$1,920.6 million, representing 93.6% of the company's total sales.

The *Expeditionary Services* segment includes airlift and mobility activities. This division provides products and services for the movement of equipment and personnel by the U.S. Department of Defense (DoD), foreign governments and non-governmental organizations. This segment also designs manufactures and installs in-plane cargo loading and handling systems for commercial aircraft, military aircraft and helicopters. Sales during fiscal 2019 came in at \$131.2 million, contributing 6.4% to the company's total sales.



Reasons To Buy:

- ▲ AAR Corp. continues to witness strong performance in its parts supply and program activities. In fact, solid sales from its parts supply activities have been one of the primary catalysts behind the company's fiscal second-quarter top-line growth. Moreover, this is the company's sixth consecutive quarter of double-digit sales growth. The company's investments toward its parts supply activities have enabled it to capitalize on the continued robust demand for parts. Further, during the fiscal second quarter, AAR Corp expanded the scope of its component repair services program with BAE for its regional jet support programs to include more components. Banking on such initiatives, management expects to witness continued growth in the company's parts supply business in the days ahead.
- ▲ Coming to its latest business wins, during the quarter, the company's Airinmar subsidiary, a provider of component repair cycle management solutions, announced two new contract wins. The first one was an agreement with Alaska Airlines for a digital trial of its Airvolution software platform, which enables the customer to enhance efficiency and reduce costs by increasing visibility into their component repair cycle. It also signed a three-year agreement with JetBlue to provide component value engineering cost oversight services. Such significant contract wins reflect solid prospects for the stock.
- ▲ In fiscal 2018, AAR Corp began offering services to the U.S. Department of State (DoS) under the INL/A Worldwide Aviation Support Services (WASS) contract. This contract leverages the company's capabilities in aviation services including flight operations, supply chain logistics, and other services. Notably, the company is the prime contractor on this 10-year performance-based contract to globally operate and maintain the DoS fleet of fixed and rotary-wing aircraft. AAR Corp acquired full operational capability at all contract sites after completing the transition and phase-in of the WASS program in June 2018. This is now contributing to the company's operational results. During the fiscal fourth quarter, the company added a new site and anticipates adding more sites in near future. Such site additions can be projected to significantly boost AAR Corp's top line.

Solid performance from its parts supply program boosts AAR Corp's top line. Recent distributor agreements should bode well for the stock.

Reasons To Sell:

- ▼ AAR Corp has been witnessing labor shortages in its MRO business for quite some time. In fiscal fourth quarter as well, the company persistently faced this issue and no near-term rebound can be expected in this regard, as of now. Indeed, North America is facing labor shortage issues in its aviation industry, which has now been translated in to the aftermarket MRO industry. To this end, Oliver Wyman, a leading global management consulting firm, predicted in April 2018 that technician supply will be challenging over the next five years for the MRO aviation space, which could result in increased labor costs. Therefore, the growth prospects of AAR Corp's MRO business seem to be bleak.
- ▼ Earlier this year, the U.S. Department of Justice (DoJ) conducted an investigation of AAR Corp.'s Airlift business segment, under the federal civil False Claims Act (FCA). The investigation was carried out, as Airlift's performance related to several contracts awarded by the U.S. Transportation Command, concerning the operations and maintenance of rotary-wing and fixed-wing aircraft in Afghanistan and Africa, was scrutinized. Considering these events, AAR Corp ultimately decided to divest its Airlift assets. This divestment may negatively impact the company's operating results as it will lose the contracts it used to win for the Airlift business. This, in turn, might have hurt investors' confidence in this stock. In the past year, shares of AAR Corp were up 11.6% compared to the industry's 17.1% growth.
- ▼ AAR Corp. operates in a space that is highly competitive, and consists of both big and small industry players. To keep up with other players in this space, the company will have to spend substantially for technological progress that could adversely affect its operations and financial condition. In addition, AAR Corp. is exposed to currency fluctuation risks due to its geographically expanded client base and operations beyond the United States. Moreover, the company is subject to government regulations and may need to incur significant expenses to comply with new or more stringent laws.

Labor shortage issues in MRO business and stiff competition may limit the growth prospects of AAR Corp.

Last Earnings Report

AAR Corp Beats on Q2 Earnings, Ups Fiscal 2020 View

AAR Corp. reported second-quarter fiscal 2020 adjusted earnings of 64 cents per share, which surpassed the Zacks Consensus Estimate of 61 cents by 4.9%. The figure also reflected a year-over-year improvement of 6.7% from 60 cents reported in the year-ago quarter.

The year-over-year growth can be primarily attributed to solid improvement in sales.

Excluding one-time items, the company reported earnings of 58 cents from continuing operations compared with 32 cents in second-quarter fiscal 2019.

Quarter Ending **11/2019**

Report Date	Dec 19, 2019
Sales Surprise	6.10%
EPS Surprise	4.92%
Quarterly EPS	0.64
Annual EPS (TTM)	2.64

Total Sales

In the reported quarter, net sales of \$560.9 million exceeded the Zacks Consensus Estimate of \$529 million by 6%. The top line also increased 13.7% from \$493.3 million in the year-ago quarter.

The year-over-year increase in sales was driven by continued growth across its Aviation Services segment, which grew 15% during the quarter.

Segment Details

In the fiscal second quarter, revenues from the Aviation Services segment summed \$532 million, up 14.9% year over year, driven by strong demand for both new and aftermarket parts, significant improvement in Maintenance, Repair and Overhaul (MRO) and solid execution on our government contract awards.

Expeditionary Services generated revenues of \$28.9 million, down 4.9% from \$30.4 million in the year-ago quarter.

Highlights of the Release

AAR Corp's cost of sales in the reported quarter grew 14.5% year over year to \$475 million.

Selling, general and administrative expenses rose 16.3% to \$57.1 million.

The company incurred interest expenses of \$1.8 million compared with \$2.4 million in second-quarter fiscal 2019.

Financial Condition

As of Nov 30, 2019, AAR Corp's cash and cash equivalents amounted to \$38.2 million compared with \$21.3 million as of May 31, 2019.

As of Aug 31, net property, plant and equipment were worth \$134.3 million compared with \$132.8 million as of May 31.

As of Aug 31, long-term debt increased to \$196.1 million from \$141.7 million as of May 31.

Outlook

AAR Corp reaffirmed its financial guidance for fiscal 2020, which includes sales of \$2.15-\$2.225 billion and adjusted diluted earnings per share from continuing operations of \$2.50-\$2.65. The company expects selling, general and administrative expenses to be approximately 10.5% of sales and anticipates an effective tax rate of 24% for the fiscal.

Valuation

AAR Corp.'s shares are down 13% in the past six months period and up 11.6% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Aerospace sector are down 0.3% and 6% in the past six months period, respectively. Over the past year, the Zacks sub-industry is up 17.1% whereas the sector went up 1.9%.

The S&P 500 index is up 6.2% in the past six months period and 14% in the past year.

The stock is currently trading at 13.0X of forward 12-month earnings, which compares to 19.6X for the Zacks sub-industry, 19.5X for the Zacks sector and 17.9X for the S&P 500 index.

Over the past five years, the stock has traded as high as 24.0X and as low as 9.3X, with a 5-year median of 16.3X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$40 price target reflects 13.7X forward 12-month earnings.

The table below shows summary valuation data for AIR

Valuation Multiples - AIR					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	13.03	19.58	19.5	17.89
	5-Year High	24.03	20.63	21.54	19.34
	5-Year Low	9.33	14.51	14.26	15.18
	5-Year Median	16.34	18.07	16.9	17.46
P/S F12M	Current	0.57	1.77	1.25	3.3
	5-Year High	0.8	1.9	1.39	3.43
	5-Year Low	0.37	1.09	0.8	2.54
	5-Year Median	0.62	1.48	1.09	3.01
P/B TTM	Current	1.44	4.69	14.74	4.18
	5-Year High	1.97	5.26	16.72	4.54
	5-Year Low	0.77	2.82	5.26	2.85
	5-Year Median	1.37	3.91	9.22	3.62

As of 03/04/2020

Industry Analysis Zacks Industry Rank: Bottom 33% (172 out of 255)



Top Peers

Heico Corporation (HEI)	Outperform
Aerojet Rocketdyne Holdings, Inc. (AJRD)	Neutral
AeroVironment, Inc. (AVAV)	Neutral
Curtiss-Wright Corporation (CW)	Neutral
Kratos Defense & Security Solutions, Inc. (KTOS)	Neutral
Astronics Corporation (ATRO)	Underperform
Hexcel Corporation (HXL)	Underperform
Triumph Group, Inc. (TGI)	Underperform

Industry Comparison Industry: Aerospace - Defense Equipment				Industry Peers		
	AIR Neutral	X Industry	S&P 500	AJRD Neutral	ATRO Underperform	HXL Underperform
VGM Score	A	-	-	C	C	B
Market Cap	1.33 B	1.37 B	22.29 B	4.15 B	610.96 M	5.79 B
# of Analysts	2	3	13	2	2	3
Dividend Yield	0.79%	0.00%	1.97%	0.00%	0.00%	0.98%
Value Score	A	-	-	C	B	D
Cash/Price	0.04	0.07	0.05	0.24	0.04	0.01
EV/EBITDA	11.00	11.81	13.20	11.58	8.00	11.93
PEG Ratio	NA	2.76	1.94	NA	2.87	3.46
Price/Book (P/B)	1.44	2.94	3.05	7.20	1.57	4.05
Price/Cash Flow (P/CF)	10.52	13.13	12.16	19.39	9.75	13.13
P/E (F1)	14.51	24.90	17.58	28.82	28.68	19.43
Price/Sales (P/S)	0.60	1.47	2.45	2.09	0.79	2.46
Earnings Yield	6.89%	3.98%	5.69%	3.47%	3.49%	5.14%
Debt/Equity	0.30	0.35	0.70	0.68	0.48	0.73
Cash Flow (\$/share)	3.62	2.37	7.01	2.72	2.03	5.29
Growth Score	B	-	-	B	C	B
Hist. EPS Growth (3-5 yrs)	29.48%	13.63%	10.85%	40.53%	-20.14%	10.06%
Proj. EPS Growth (F1/F0)	11.02%	8.83%	6.26%	8.28%	-24.18%	0.94%
Curr. Cash Flow Growth	22.00%	4.47%	6.03%	-8.04%	-23.43%	12.73%
Hist. Cash Flow Growth (3-5 yrs)	-5.67%	8.37%	8.52%	70.16%	14.18%	9.27%
Current Ratio	2.64	2.35	1.23	1.63	2.84	2.19
Debt/Capital	23.31%	29.68%	42.57%	40.43%	32.59%	42.08%
Net Margin	0.18%	6.73%	11.69%	7.12%	6.73%	13.02%
Return on Equity	10.18%	8.88%	16.66%	24.42%	6.44%	21.39%
Sales/Assets	1.35	0.76	0.54	0.76	0.99	0.75
Proj. Sales Growth (F1/F0)	9.24%	0.33%	3.94%	5.20%	-11.59%	0.67%
Momentum Score	B	-	-	F	F	B
Daily Price Chg	4.16%	0.50%	3.75%	4.93%	0.66%	3.94%
1 Week Price Chg	-24.45%	-12.38%	-12.06%	-9.06%	-17.43%	-14.78%
4 Week Price Chg	-14.56%	-9.92%	-7.42%	-1.81%	-25.80%	-6.90%
12 Week Price Chg	-15.40%	-7.57%	-4.61%	19.65%	-32.57%	-11.82%
52 Week Price Chg	10.78%	1.50%	7.38%	56.04%	-39.00%	-1.48%
20 Day Average Volume	175,170	175,170	2,456,671	639,852	210,488	811,928
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	-3.50%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	-0.06%	-4.33%	-37.56%	-1.29%
(F1) EPS Est 12 week change	0.13%	-0.40%	-0.41%	-4.49%	-55.10%	-8.22%
(Q1) EPS Est Mthly Chg	0.00%	-0.85%	-0.27%	-7.64%	NA	NA

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	A
Growth Score	B
Momentum Score	B
VGM Score	A

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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