

AAR Corp. (AIR)

\$19.23 (As of 07/23/20)

Price Target (6-12 Months): **\$20.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 04/20/20)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:B

Value: A

Growth: C

Momentum: D

Summary

AAR Corp. ended fourth-quarter fiscal 2020 with both earnings and revenues outpacing the Zacks Consensus Estimate. It continues to witness strong performance in its parts supply and program activities. Strategic investments toward AAR Corp.'s parts supply activities have enabled the company to capitalize on steady parts demand. Additionally, it expects elevated demand for used materials as airline companies look to save money using aftermarket parts. However, it has underperformed the industry in the year-to-date period. AAR Corp. continues to witness labor shortages in its MRO business and the issue is expected to linger in the near term. It also operates in a space that is highly competitive. Further, AAR Corp. expects the global impact of the pandemic to significantly mar its commercial airline business.

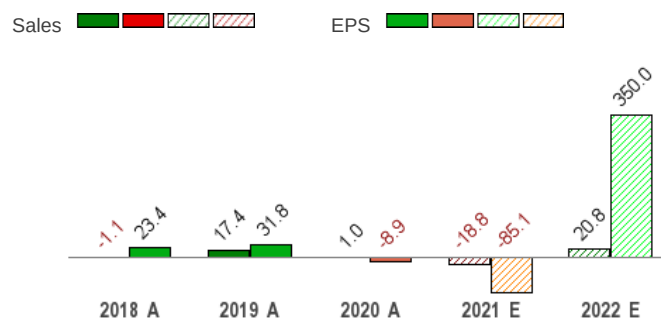
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$52.78 - \$8.56
20 Day Average Volume (sh)	382,411
Market Cap	\$676.0 M
YTD Price Change	-57.4%
Beta	1.69
Dividend / Div Yld	\$0.30 / 1.6%
Industry	Aerospace - Defense Equipment
Zacks Industry Rank	Bottom 8% (232 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	208.3%
Last Sales Surprise	27.8%
EPS F1 Est- 4 week change	-19.0%
Expected Report Date	09/23/2020
Earnings ESP	-145.5%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2022	483 E	509 E	514 E	509 E	2,032 E
2021	382 E	383 E	436 E	481 E	1,682 E
2020	542 A	561 A	553 A	417 A	2,072 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2022	\$0.30 E	\$0.32 E	\$0.39 E	\$0.43 E	\$1.44 E
2021	-\$0.11 E	-\$0.03 E	\$0.17 E	\$0.29 E	\$0.32 E
2020	\$0.57 A	\$0.64 A	\$0.67 A	\$0.26 A	\$2.15 A

*Quarterly figures may not add up to annual.

P/E TTM	9.0
P/E F1	60.1
PEG F1	NA
P/S TTM	0.3

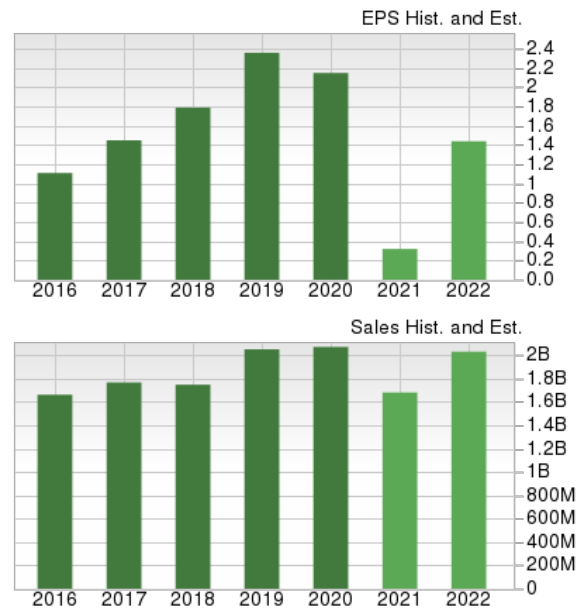
The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 07/23/2020. The reports text is as of 07/24/2020.

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 provides aftermarket support and services for the commercial aviation, and government and defense markets and accounted for approximately 95% of sales in fiscal 2020. It comprises supply chain maintenance, repair and overhaul (MRO) activities. The company sells and leases a wide variety of new, overhauled and repaired engine and airframe parts and components, and aircraft to its commercial aviation and government/defense customers. It provides inventory management and distribution services, overhaul, repair and engineering services. Segment sales in fiscal 2020 were \$1,964.2 million, representing 94.8% 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. Business activities in this segment are primarily conducted through AAR Manufacturing, Inc. and Brown International Corporation. Sales during fiscal 2020 came in at \$107.8 million, contributing 5.2% 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 third-quarter top-line growth. The company's investments toward its parts supply activities have enabled it to capitalize on the continued robust demand for parts.
- ▲ Additionally, it expects elevated demand for used materials as airline companies look to save money using aftermarket parts. AAR Corp., being the largest aftermarket parts supplier in the world, will benefit from increased supply. Moreover, the company anticipates the competition in the aftermarket, which has intensified in recent years due to the length of the up cycle, to decrease as competitors struggle to survive or increasingly focus on core activities. 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 developments, the company received a \$125 million contract from the U.S. Air Force to produce and repair 463L cargo pallets in the fiscal fourth quarter. Further in keeping with its long-term strategy to focus on aviation services, the company entered into an agreement with an affiliate of Architect Equity to sell its Composites manufacturing business, which is expected to close in the first half of fiscal 2021.

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

During the quarter, AAR Corp. also announced the formation of a joint venture with Sumitomo Corporation to provide aviation aftermarket supply-chain solutions to Japanese defense and global commercial markets. Subsequent to the fourth quarter, the company had announced an extension and expansion of its exclusive worldwide aftermarket distribution agreement with Unison Industries covering their electrical components, sensors, and systems for aircraft and industrial uses. The agreement, valued at more than \$1 billion over the 11-year term, validates the robust value proposition that its distribution team provides to OEMs in the aviation aftermarket. Such joint ventures and contract signing can be expected to enhance AAR Corp.'s footprint in the aerospace and defense space.

Reasons To Sell:

- ▼ AAR Corp has been witnessing labor shortages in its MRO business for quite some time. 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.
- ▼ In 2019, 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 might negatively impact the company's operating results, as it will lose the contracts it used to win for the Airlift business. This, in turn, will likely dampen investors' confidence in the stock. In the year to date period, shares of AAR Corp have plunged 54.4% compared with the industry's 39.9% decline.
- ▼ AAR Corp's cash equivalents as on May 31, 2020, remained considerably lower compared to its long-term debt levels. Evidently, at the end of the fourth-quarter fiscal 2020, its cash equivalents were \$404.7 million, while its long-term debt stood at \$600 million as of May 31, 2020. A comparative analysis of these figures reflects the fragility of AAR Corp's cash reserve, against its long-term debt value. This along with the ongoing uncertainty related to the COVID-19 pandemic makes us skeptic about the company's ability to duly meet its obligations in the near future.

Labor shortage issues in MRO business and unfavorable financial ratio may limit the growth prospects of AAR Corp.

Moreover, the company's interest coverage came in at 4.3 as of May 31, 2020, down sequentially from 9.7 and also lowest in the last four quarters. Such unfavorable financial ratio indicates that AAR Corp. might face difficulties and struggle to meet debt obligations, at least in the near future.

Last Earnings Report

AAR Corp Q4 Earnings Beat Estimates, Sales Fall Y/Y

AAR Corp. reported fourth-quarter fiscal 2020 adjusted earnings of 26 cents per share, while the Zacks Consensus Estimate was pegged at a loss of 24 cents.

The figure reflected a year-over-year decline of 59.4% from earnings of 64 cents registered in the year-ago quarter.

Excluding one-time items, the company reported a loss of 43 cents per share from continuing operations compared with 76 cents in fourth-quarter fiscal 2019.

AAR Corp's adjusted earnings for fiscal 2020 came in at 71 cents per share, which lagged the Zacks Consensus Estimate of \$1.65 by 57% and the year-ago earnings of \$2.40.

Quarter Ending 05/2020

Report Date	Jul 21, 2020
Sales Surprise	27.81%
EPS Surprise	208.33%
Quarterly EPS	0.26
Annual EPS (TTM)	2.14

Total Sales

In the quarter under review, net sales totaled \$416.5 million. The reported figure outpaced the Zacks Consensus Estimate of \$326 million by 27.8% but plunged 26% from \$562.7 million recorded in the year-ago quarter.

The year-over-year decline in sales was due to the impact of COVID-19 and the unprecedented grounding of all commercial fleet.

AAR Corp's full-year sales came to \$2.07 billion, up 1% from \$2.05 billion reported in the year-ago quarter.

Segment Details

In the fiscal fourth quarter, sales at the Aviation Services segment summed \$390.1 million, down 25.3% year over year.

Expeditionary Services garnered sales of \$26.4 million, down 35.1% from \$40.7 million in the year-ago quarter.

Highlights of the Release

AAR Corp's cost of sales in the reported quarter fell 18.8% year over year to \$380.1 million.

Selling, general and administrative expenses declined 25.3% to \$47.3 million.

The company incurred interest expenses of \$2.6 million compared with \$2.1 million in fourth-quarter fiscal 2019.

During the quarter under review, the company paid out cash dividends of \$2.6 million.

Financial Condition

As of May 31, 2020, AAR Corp's cash and cash equivalents amounted to \$404.7 million compared with \$21.3 million as of May 31, 2019.

As of May 31, 2020, net property, plant and equipment expenses totaled \$135.7 million compared with \$132.8 million as of May 31, 2019.

As of May 31, 2020, total debt decreased to \$602 million from \$142.9 million as of May 31, 2019.

Recent News

On **Jul 15, 2020**, AAR Corp. and Unison Industries jointly announced the expansion and extension of the longstanding partnership as the exclusive worldwide aftermarket distributor for Unison Industries' aviation, aerospace, military, civil and land vehicles products. The agreement, valued at more than \$1 billion over 11-year period, adds new material content to include new product introduction spanning multiple aircraft platforms.

On **May 8, 2020**, AAR Corp's Integrated Technologies division has been awarded a firm-fixed-price (FFP) contract from the US Air Force Life Cycle Management Center (AFLCMC) Tinker AFB, Oklahoma, to provide contractor logistical support (CLS) for a fleet of 18 AN/MSN-7 Communication Central Systems. The support requirements include program management, supply of all the AN/MSN-7 parts, support equipment components, all system materials and consumables as well as replenishment of spare parts. The effort also requires AAR to provide depot-level maintenance and system level down to Line Replaceable Unit (LRU) level repair as needed, procurement, and installation services on an as required basis. The firm-fixed-price contract with AAR Integrated Technologies is for five years (base year with four one year renewal options) for an estimated value of \$5.1 million.

Valuation

AAR Corp.'s shares are down 57.4% in the year-to-date period and 54.4% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Aerospace sector are down 42% and 29.3% in the year to date period, respectively. Over the past year, the Zacks sub-industry and sector are down 39.9% and 30.7%, respectively.

The S&P 500 index is up 1.9% in the year to date period and 9.9% in the past year.

The stock is currently trading at 0.4X forward 12-month sales, which compares to 0.9X for the Zacks sub-industry, 1.2X for the Zacks sector and 3.6X for the S&P 500 index.

Over the past five years, the stock has traded as high as 0.8X and as low as 0.1X, with a 5-year median of 0.6X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$20 price target reflects 0.42X forward 12-month sales.

The table below shows summary valuation data for AIR

Valuation Multiples - AIR					
		Stock	Sub-Industry	Sector	S&P 500
P/S F12M	Current	0.4	0.89	1.17	3.62
	5-Year High	0.8	1.29	1.49	3.62
	5-Year Low	0.14	0.79	0.92	2.53
	5-Year Median	0.61	1.01	1.17	3.02
EV/SALES F12M	Current	0.54	1.33	1.46	3.17
	5-Year High	0.9	1.76	1.99	3.52
	5-Year Low	0.31	1.06	0.99	2.28
	5-Year Median	0.68	1.34	1.41	2.84
P/B TTM	Current	0.73	1.54	3.91	4.49
	5-Year High	1.97	2.8	6.77	4.56
	5-Year Low	0.36	1.2	3.03	2.83
	5-Year Median	1.34	2.26	5.13	3.71

As of 07/23/2020

Industry Analysis Zacks Industry Rank: Bottom 8% (232 out of 252)



Top Peers

Company (Ticker)	Rec	Rank
Astronics Corporation (ATRO)	Neutral	4
AeroVironment, Inc. (AVAV)	Neutral	3
CurtissWright Corporation (CW)	Neutral	3
Heico Corporation (HEI)	Neutral	3
Hexcel Corporation (HXL)	Neutral	2
Kratos DefenseSecurity Solutions, Inc. (KTOS)	Neutral	4
Triumph Group, Inc. (TGI)	Neutral	4
Aerojet Rocketdyne Holdings, Inc. (AJRD)	Underperform	4

Industry Comparison Industry: Aerospace - Defense Equipment				Industry Peers		
	AIR	X Industry	S&P 500	AJRD	ATRO	HXL
Zacks Recommendation (Long Term)	Neutral	-	-	Underperform	Neutral	Neutral
Zacks Rank (Short Term)	4	-	-	4	4	2
VGM Score	B	-	-	D	A	D
Market Cap	676.04 M	1.21 B	22.58 B	2.99 B	286.48 M	3.90 B
# of Analysts	2	4	14	2	2	5
Dividend Yield	1.56%	0.00%	1.81%	0.00%	0.00%	0.00%
Value Score	A	-	-	C	B	C
Cash/Price	0.10	0.15	0.06	0.30	0.66	0.09
EV/EBITDA	9.07	7.93	13.13	7.93	4.01	8.74
PEG Ratio	NA	6.46	3.04	NA	NA	6.00
Price/Book (P/B)	0.75	1.87	3.15	4.84	0.91	2.74
Price/Cash Flow (P/CF)	5.68	7.00	12.33	13.99	4.61	8.83
P/E (F1)	60.13	28.02	22.09	21.55	NA	33.85
Price/Sales (P/S)	0.33	1.02	2.41	1.52	0.40	1.71
Earnings Yield	1.66%	2.98%	4.30%	4.63%	-30.61%	2.95%
Debt/Equity	0.74	0.39	0.76	0.63	1.06	0.98
Cash Flow (\$/share)	3.39	2.26	7.01	2.72	2.02	5.29
Growth Score	C	-	-	D	A	F
Hist. EPS Growth (3-5 yrs)	37.86%	10.59%	10.82%	37.62%	-23.19%	10.08%
Proj. EPS Growth (F1/F0)	-85.12%	-31.76%	-9.01%	4.44%	-412.64%	-61.02%
Curr. Cash Flow Growth	-5.56%	12.73%	5.47%	-8.04%	-23.43%	12.73%
Hist. Cash Flow Growth (3-5 yrs)	-5.67%	5.32%	8.55%	70.16%	-8.28%	9.27%
Current Ratio	3.76	2.78	1.31	1.67	4.11	3.36
Debt/Capital	42.64%	37.95%	44.41%	38.69%	51.48%	49.44%
Net Margin	0.21%	5.34%	10.46%	6.80%	-12.89%	12.10%
Return on Equity	8.21%	9.47%	15.13%	21.60%	3.49%	19.92%
Sales/Assets	1.13	0.74	0.54	0.74	0.91	0.71
Proj. Sales Growth (F1/F0)	-18.83%	0.00%	-2.06%	3.33%	-38.79%	-32.25%
Momentum Score	D	-	-	C	C	B
Daily Price Chg	1.16%	0.00%	-0.20%	-0.81%	0.59%	1.61%
1 Week Price Chg	0.37%	1.52%	3.82%	5.86%	1.30%	4.38%
4 Week Price Chg	0.16%	0.04%	6.02%	-6.21%	-7.59%	7.73%
12 Week Price Chg	-1.79%	4.37%	10.03%	-7.54%	3.73%	35.04%
52 Week Price Chg	-54.43%	-28.93%	-2.89%	-13.03%	-75.62%	-43.66%
20 Day Average Volume	382,411	188,128	2,026,477	613,329	302,583	909,499
(F1) EPS Est 1 week change	-4.48%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-18.99%	-1.37%	0.15%	-0.40%	-6.85%	9.23%
(F1) EPS Est 12 week change	-18.99%	-7.17%	-3.24%	-9.40%	5.45%	-7.17%
(Q1) EPS Est Mthly Chg	-15.79%	-1.49%	0.00%	0.00%	-3.70%	1,633.33%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

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	C
Momentum Score	D
VGM Score	B

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.

Disclosures

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