

AAR Corp. (AIR)

\$17.99 (As of 03/27/20)

Price Target (6-12 Months): **\$15.00**

Long Term: 6-12 Months | **Zacks Recommendation:** **Underperform**
(Since: 03/22/20)
Prior Recommendation: Neutral

Short Term: 1-3 Months | **Zacks Rank:** (1-5) **5-Strong Sell**
Zacks Style Scores: VGM:D
Value: B | Growth: D | Momentum: F

Summary

AAR Corp. ended third-quarter fiscal 2020 on a mixed note, with earnings surpassing the Zacks Consensus Estimate and revenues missing the same. The company continues to witness labor shortages in its MRO business and the issue is expected to linger in the near term. AAR Corp. operates in a space that is highly competitive. To keep up with other players in this space, it will have to spend substantially for technological progress that could adversely affect its operations and financial condition. In addition, AAR Corp. expects the global impact of the coronavirus outbreak to significantly mar its commercial airline business. Further, it has underperformed the industry in the past year. However, strategic investments toward AAR Corp.'s parts supply activities have enabled the company to capitalize on steady parts demand.

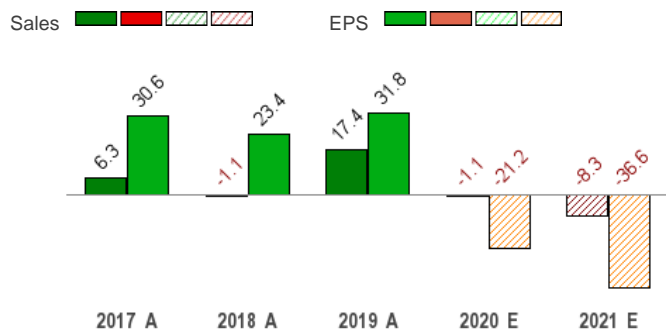
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$52.78 - \$8.56
20 Day Average Volume (sh)	644,713
Market Cap	\$628.1 M
YTD Price Change	-60.1%
Beta	1.33
Dividend / Div Yld	\$0.30 / 1.7%
Industry	Aerospace - Defense Equipment
Zacks Industry Rank	Bottom 27% (186 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	1.5%
Last Sales Surprise	-0.8%
EPS F1 Est- 4 week change	-31.1%
Expected Report Date	NA
Earnings ESP	0.0%
P/E TTM	7.1
P/E F1	9.7
PEG F1	NA
P/S TTM	0.3

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	259 E	405 E	444 E	498 E	1,861 E
2020	542 A	561 A	553 A	370 E	2,030 E
2019	466 A	493 A	530 A	563 A	2,052 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.39 E	\$0.47 E	\$0.46 E	\$0.63 E	\$1.18 E
2020	\$0.57 A	\$0.64 A	\$0.67 A	-\$0.03 E	\$1.86 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.

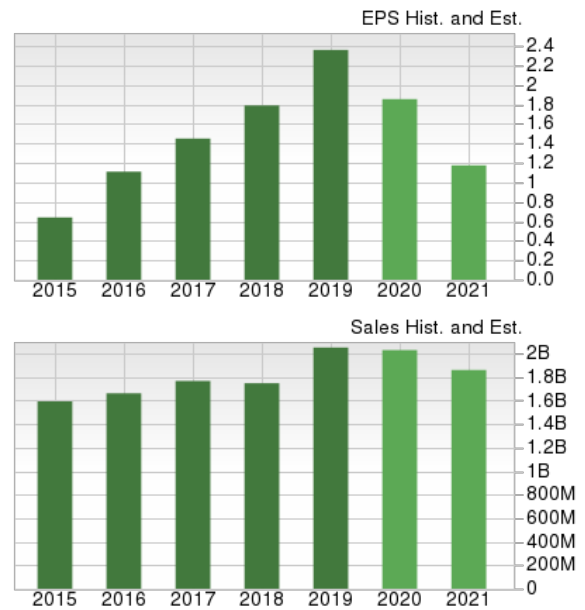
The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 03/27/2020. The reports text is as of 03/30/2020.

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 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 past year, shares of AAR Corp have plunged 46.3% compared with the industry's 24.3% decline.
- ▼ 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, the company expects the crippling impact of the coronavirus outbreak, globally, to significantly hurt its commercial airline business.

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

Risks

- 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, will 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 wins, during the fiscal third quarter, the company was selected by AeroControlex, a large manufacturer of critical components to the aviation industry, to be the latter's exclusive global distributor for the APU lube pump product line. AAR Corp. also secured a \$90-million sole-source IDIQ contract with the Defense Logistics Agency for specialized shipping and storage containers as well as accessories. Also during the quarter, the company announced plans to expand its airframe maintenance services with Air Canada to cover the A330 fleet. Such significant contract wins reflect growth prospects for the stock.
-

Last Earnings Report

AAR Corp. Earnings Beat Estimates in Q3, Sales Miss

AAR Corp. reported third-quarter fiscal 2020 adjusted earnings of 67 cents per share, which surpassed the Zacks Consensus Estimate of 66 cents by 1.5%. The figure also reflected a year-over-year improvement of 8.1% from 62 cents.

Excluding one-time items, the company reported earnings of 7 cents from continuing operations compared with 78 cents in third-quarter fiscal 2019.

Quarter Ending **02/2020**

Report Date	Mar 24, 2020
Sales Surprise	-0.80%
EPS Surprise	1.52%
Quarterly EPS	0.67
Annual EPS (TTM)	2.52

Total Sales

In the reported quarter, net sales of \$553.1 million missed the Zacks Consensus Estimate of \$558 million by 0.9%. However, the top line grew 4.5% from \$529.5 million in the year-ago quarter.

The year-over-year improvement in sales was driven by continued growth in the company's Aviation Services segment.

Segment Details

In the fiscal third quarter, sales from the Aviation Services segment summed \$530.3 million, up 6.6% year over year.

Expeditionary Services registered sales of \$22.8 million, down 29.1% from \$32.2 million in the year-ago quarter.

Highlights of the Release

AAR Corp.'s cost of sales in the reported quarter increased 9.8% year over year to \$487.8 million.

Selling, general and administrative expenses rose 6% to \$58.1 million.

The company incurred interest expenses of \$2.3 million compared with \$2.4 million in third-quarter fiscal 2019.

During the quarter, the company paid out cash dividends of \$2.6 million, in line with the cash dividends paid out in third-quarter fiscal 2019.

Financial Condition

As of Feb 29, 2020, AAR Corp.'s cash and cash equivalents amounted to \$37 million compared with \$21.3 million, as of May 31, 2019.

As of Feb 29, 2020, net property, plant and equipment expenses were \$136.7 million compared with \$132.8 million, as of May 31, 2019.

As of Feb 29, 2020, long-term debt decreased to \$206 million from \$141.7 million, as of May 31, 2019.

Recent News

On **Feb 12, 2020**, AAR Corp. announced a Memorandum of Understanding (MOU) to provide consulting services for Korean Aerospace Engineering & Maintenance Services (KAEMS). The two companies will collaborate to define required capabilities and infrastructure for a new KAEMS facility in South Korea that will provide component maintenance for the Republic of Korea Air Force's (ROKAF) F-16 fleet. The MOU includes training for KAEMS employees at AAR's component repair facilities in Amsterdam and New York.

Valuation

AAR Corp.'s shares are down 60.1% in the year-to-date period and down 46.3% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Aerospace sector are down 34.1% and 29.5% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry is down 24.3% whereas the sector declined 27.3%.

The S&P 500 index is down 21.1% in the year-to-date period and down 11.8% in the past year.

The stock is currently trading at 6.1X of forward 12-month earnings, which compares to 14X for the Zacks sub-industry, 15.3X for the Zacks sector and 16.0X for the S&P 500 index.

Over the past five years, the stock has traded as high as 24.0X and as low as 3.2X, with a 5-year median of 16.3X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our \$15 price target reflects 5.1X 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	6.11	14	15.29	16.03
	5-Year High	24.03	20.63	24.54	19.34
	5-Year Low	3.22	14	14.26	15.18
	5-Year Median	16.29	18.01	16.88	17.42
P/S F12M	Current	0.27	1.2	0.94	2.85
	5-Year High	0.8	1.88	1.39	3.43
	5-Year Low	0.14	1.09	0.8	2.54
	5-Year Median	0.62	1.47	1.09	3
P/B TTM	Current	0.68	3.47	11.16	3.42
	5-Year High	1.97	5.71	17.27	4.55
	5-Year Low	0.36	2.67	5.26	2.85
	5-Year Median	1.37	3.92	9.29	3.63

As of 03/27/2020

Industry Analysis Zacks Industry Rank: Bottom 27% (186 out of 254)



Top Peers

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

Industry Comparison Industry: Aerospace - Defense Equipment				Industry Peers		
	AIR Underperform	X Industry	S&P 500	AJRD Neutral	ATRO Neutral	HXL Underperform
VGM Score	D	-	-	B	C	A
Market Cap	628.10 M	977.39 M	17.63 B	3.22 B	287.53 M	3.21 B
# of Analysts	2	3	13	2	2	3
Dividend Yield	1.67%	0.00%	2.41%	0.00%	0.00%	1.77%
Value Score	B	-	-	C	B	C
Cash/Price	0.11	0.13	0.07	0.31	0.14	0.02
EV/EBITDA	6.10	8.35	10.81	8.58	4.13	7.39
PEG Ratio	NA	1.93	1.69	NA	2.88	1.93
Price/Book (P/B)	0.68	2.08	2.35	5.58	0.75	2.25
Price/Cash Flow (P/CF)	4.98	7.97	9.47	15.03	4.63	7.28
P/E (F1)	9.29	14.90	14.74	22.34	28.80	10.82
Price/Sales (P/S)	0.28	1.18	1.89	1.62	0.37	1.36
Earnings Yield	10.34%	6.78%	6.73%	4.48%	3.42%	9.25%
Debt/Equity	0.31	0.34	0.70	0.68	0.48	0.73
Cash Flow (\$/share)	3.62	2.37	7.01	2.72	2.02	5.29
Growth Score	D	-	-	B	C	B
Hist. EPS Growth (3-5 yrs)	29.48%	13.53%	10.85%	40.53%	-20.14%	10.06%
Proj. EPS Growth (F1/F0)	-21.40%	5.72%	2.89%	8.28%	-64.29%	0.47%
Curr. Cash Flow Growth	22.00%	6.03%	5.93%	-8.04%	-23.43%	12.73%
Hist. Cash Flow Growth (3-5 yrs)	-5.67%	4.09%	8.55%	70.16%	-8.28%	9.27%
Current Ratio	2.39	2.35	1.23	1.63	2.84	2.19
Debt/Capital	23.53%	29.68%	42.57%	40.43%	32.59%	42.08%
Net Margin	1.97%	6.73%	11.64%	7.12%	6.73%	13.02%
Return on Equity	9.69%	8.64%	16.74%	24.42%	6.44%	21.39%
Sales/Assets	1.31	0.76	0.54	0.76	0.99	0.75
Proj. Sales Growth (F1/F0)	-1.05%	0.00%	2.37%	5.20%	-28.20%	0.67%
Momentum Score	F	-	-	B	C	A
Daily Price Chg	-9.82%	-3.10%	-3.35%	-4.89%	-3.90%	-12.90%
1 Week Price Chg	-29.63%	-19.65%	-16.96%	-10.71%	-49.90%	-36.89%
4 Week Price Chg	-49.68%	-26.51%	-18.79%	-18.92%	-52.46%	-42.87%
12 Week Price Chg	-60.68%	-34.51%	-25.68%	-12.78%	-66.52%	-48.92%
52 Week Price Chg	-44.39%	-22.86%	-17.12%	16.93%	-70.37%	-44.20%
20 Day Average Volume	644,713	333,522	4,286,768	1,047,098	436,996	1,605,698
(F1) EPS Est 1 week change	-17.96%	0.00%	-0.15%	0.00%	0.00%	-0.47%
(F1) EPS Est 4 week change	-31.11%	-0.83%	-2.28%	0.91%	-66.84%	-0.47%
(F1) EPS Est 12 week change	-31.11%	-6.31%	-3.22%	-4.49%	-78.85%	-8.65%
(Q1) EPS Est Mthly Chg	-110.20%	-0.92%	-1.60%	-2.56%	NA	1.20%

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	B
Growth Score	D
Momentum Score	F
VGM Score	D

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

This report contains independent commentary to be used for informational purposes only. The analysts contributing to this report do not hold any shares of this stock. The analysts contributing to this report do not serve on the board of the company that issued this stock. The EPS and revenue forecasts are the Zacks Consensus estimates, unless indicated otherwise on the reports first page. Additionally, the analysts contributing to this report certify that the views expressed herein accurately reflect the analysts personal views as to the subject securities and issuers. ZIR certifies that no part of the analysts compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst in the report.

Additional information on the securities mentioned in this report is available upon request. This report is based on data obtained from sources we believe to be reliable, but is not guaranteed as to accuracy and does not purport to be complete. Any opinions expressed herein are subject to change.

ZIR is not an investment advisor and the report should not be construed as advice designed to meet the particular investment needs of any investor. Prior to making any investment decision, you are advised to consult with your broker, investment advisor, or other appropriate tax or financial professional to determine the suitability of any investment. This report and others like it are published regularly and not in response to episodic market activity or events affecting the securities industry.

This report is not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned. ZIR or its officers, employees or customers may have a position long or short in the securities mentioned and buy or sell the securities from time to time. ZIR is not a broker-dealer. ZIR may enter into arms-length agreements with broker-dealers to provide this research to their clients. Zacks and its staff are not involved in investment banking activities for the stock issuer covered in this report.

ZIR uses the following rating system for the securities it covers. **Outperform-** ZIR expects that the subject company will outperform the broader U.S. equities markets over the next six to twelve months. **Neutral-** ZIR expects that the company will perform in line with the broader U.S. equities markets over the next six to twelve months. **Underperform-** ZIR expects the company will underperform the broader U.S. equities markets over the next six to twelve months.

No part of this report can be reprinted, republished or transmitted electronically without the prior written authorization of ZIR.