

AAR CORP  
Form 10-Q  
December 19, 2014  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

**x** **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the Quarterly Period Ended November 30, 2014**

**or**

**o** **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from      to**

**Commission File No. 1-6263**

**AAR CORP.**

(Exact name of registrant as specified in its charter)

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

**36-2334820**  
(I.R.S. Employer Identification No.)

**One AAR Place, 1100 N. Wood Dale Road**

**Wood Dale, Illinois**  
(Address of principal executive offices)

**60191**  
(Zip Code)

**(630) 227-2000**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of November 30, 2014, there were 39,790,994 shares of the registrant's Common Stock, \$1.00 par value per share, outstanding.



# Edgar Filing: AAR CORP - Form 10-Q

## Table of Contents

AAR CORP. and Subsidiaries

Quarterly Report on Form 10-Q

For the Quarter Ended November 30, 2014

## Table of Contents

	<b>Page</b>
<b><u>Part I FINANCIAL INFORMATION</u></b>	
<u>Item 1.</u>	<u>Financial Statements</u>
	<u>Condensed Consolidated Balance Sheets</u> 3
	<u>Condensed Consolidated Statements of Income</u> 5
	<u>Condensed Consolidated Statements of Comprehensive Income</u> 6
	<u>Condensed Consolidated Statements of Cash Flows</u> 7
	<u>Condensed Consolidated Statement of Changes in Equity</u> 8
	<u>Notes to Condensed Consolidated Financial Statements</u> 9
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> 18
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u> 23
<u>Item 4.</u>	<u>Controls and Procedures</u> 24
<b><u>Part II OTHER INFORMATION</u></b>	
<u>Item 1A.</u>	<u>Risk Factors</u> 25
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u> 25
<u>Item 6.</u>	<u>Exhibits</u> 25
<u>Signature Page</u>	26
<u>Exhibit Index</u>	27

Table of Contents**PART I FINANCIAL INFORMATION****Item 1 Financial Statements**

## AAR CORP. and Subsidiaries

## Condensed Consolidated Balance Sheets

As of November 30, 2014 and May 31, 2014

(In millions, except share data)

**ASSETS**

	November 30, 2014 (Unaudited)	May 31, 2014
<b>Current assets:</b>		
Cash and cash equivalents	\$ 92.6	\$ 89.2
Accounts receivable, less allowances of \$5.9 and \$6.2, respectively	319.3	283.1
Inventories	554.8	495.3
Rotable spares and equipment on or available for short-term lease	139.9	137.6
Deposits, prepaids and other	77.7	81.6
Deferred tax assets	30.5	30.1
Total current assets	1,214.8	1,116.9
Property, plant and equipment, net of accumulated depreciation of \$427.0 and \$424.3, respectively	288.5	314.9
<b>Other assets:</b>		
Goodwill	252.1	261.7
Intangible assets, net of accumulated amortization of \$38.7 and \$36.2, respectively	150.2	165.4
Equipment on or available for long-term lease	105.9	98.4
Capitalized program development costs	84.3	112.2
Investment in joint ventures	29.4	29.9
Other	102.5	100.1
	724.4	767.7
	\$ 2,227.7	\$ 2,199.5

The accompanying Notes to Condensed Consolidated Financial

Statements are an integral part of these statements.



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Table of Contents

AAR CORP. and Subsidiaries

Condensed Consolidated Balance Sheets

As of November 30, 2014 and May 31, 2014

(In millions, except share data)

**LIABILITIES AND EQUITY**

	November 30, 2014 (Unaudited)	May 31, 2014
<b>Current liabilities:</b>		
Current maturities of long-term debt	\$ 46.3	\$ 69.7
Accounts and trade notes payable	207.6	171.1
Accrued liabilities	146.0	161.3
Total current liabilities	399.9	402.1
Long-term debt, less current maturities	589.0	564.3
Deferred tax liabilities	169.0	162.2
Other liabilities and deferred income	67.7	70.2
	825.7	796.7
<b>Equity:</b>		
Preferred stock, \$1.00 par value, authorized 250,000 shares; none issued		
Common stock, \$1.00 par value, authorized 100,000,000 shares; issued 44,958,082 and 44,674,186 shares at cost, respectively	45.0	44.7
Capital surplus	439.9	436.4
Retained earnings	669.6	646.0
Treasury stock, 5,167,088 and 5,113,939 shares at cost, respectively	(100.4)	(98.3)
Accumulated other comprehensive loss	(52.8)	(29.3)
Total AAR stockholders' equity	1,001.3	999.5
Noncontrolling interest	0.8	1.2
Total equity	1,002.1	1,000.7
	\$ 2,227.7	\$ 2,199.5

The accompanying Notes to Condensed Consolidated Financial

Statements are an integral part of these statements.

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## Table of Contents

### AAR CORP. and Subsidiaries

#### Condensed Consolidated Statements of Income

For the Three and Six Months Ended November 30, 2014 and 2013

(Unaudited)

(In millions)

	Three Months Ended November 30,		Six Months Ended November 30,	
	2014	2013	2014	2013
<b>Sales:</b>				
Sales from products	\$ 307.7	\$ 328.9	\$ 602.4	\$ 634.4
Sales from services	182.3	211.8	356.8	420.8
	490.0	540.7	959.2	1,055.2
<b>Cost and operating expenses:</b>				
Cost of products	264.9	286.0	520.0	555.0
Cost of services	146.6	163.7	285.4	324.5
Selling, general and administrative	47.1	51.1	92.0	98.8
	458.6	500.8	897.4	978.3
Earnings from joint ventures	0.7	0.8	1.3	2.0
Operating income	32.1	40.7	63.1	78.9
Interest expense	(9.6)	(10.5)	(19.2)	(21.5)
Interest income	0.1	0.3	0.2	0.6
Income before provision for income taxes	22.6	30.5	44.1	58.0
Provision for income taxes	7.4	10.5	14.4	20.0
Net income attributable to AAR and noncontrolling interest	15.2	20.0	29.7	38.0
Income attributable to noncontrolling interest			(0.1)	(0.1)
Net income attributable to AAR	\$ 15.2	\$ 20.0	\$ 29.6	\$ 37.9
<b>Earnings per share:</b>				
Earnings per share basic	\$ 0.38	\$ 0.51	\$ 0.75	\$ 0.96
Earnings per share diluted	\$ 0.38	\$ 0.50	\$ 0.74	\$ 0.95

The accompanying Notes to Condensed Consolidated Financial

Statements are an integral part of these statements.



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Table of Contents

AAR CORP. and Subsidiaries

Condensed Consolidated Statements of Comprehensive Income

For the Three and Six Months Ended November 30, 2014 and 2013

(Unaudited)

(In millions)

	Three Months Ended November 30,		Six Months Ended November 30,	
	2014	2013	2014	2013
Net income attributable to AAR and noncontrolling interest	\$ 15.2	\$ 20.0	\$ 29.7	\$ 38.0
Other comprehensive income (loss), net of tax expense (benefit):				
Currency translation adjustments, net of tax of \$0.6 and \$0.4 for the three months ended November 30, 2014 and 2013, respectively, and \$1.0 and \$0.6 for the six months ended November 30, 2014 and 2013, respectively	(14.8)	9.0	(23.8)	11.8
Unrealized gain (loss) on derivative instruments:				
Unrealized gain (loss) arising during period, net of tax of \$0 and (\$0.2) for the three months ended November 30, 2014 and 2013, respectively, and \$0.2 and \$0.2 for the six months ended November 30, 2014 and 2013, respectively	(0.1)	(0.6)	0.2	0.3
Pension and other post-retirement plans:				
Amortization of actuarial loss and prior service cost included in net income, net of tax of \$0 and \$0.1 for the three months ended November 30, 2014 and 2013, respectively, and \$0.1 and \$0.3 for the six months ended November 30, 2014 and 2013, respectively		0.3	0.1	0.5
Other comprehensive (loss) income, net of tax	(14.9)	8.7	(23.5)	12.6
Comprehensive income, net of tax	0.3	28.7	6.2	50.6
Comprehensive income related to noncontrolling interest			(0.1)	(0.1)
Comprehensive income attributable to AAR	\$ 0.3	\$ 28.7	\$ 6.1	\$ 50.5

The accompanying Notes to Condensed Consolidated Financial

Statements are an integral part of these statements.

# Edgar Filing: AAR CORP - Form 10-Q

## Table of Contents

### AAR CORP. and Subsidiaries

#### Condensed Consolidated Statements of Cash Flows

For the Six Months Ended November 30, 2014 and 2013

(Unaudited)

(In millions)

	Six Months Ended November 30,	
	2014	2013
<b>Cash flows from operating activities:</b>		
Net income attributable to AAR and noncontrolling interest	\$ 29.7	\$ 38.0
Adjustments to reconcile net income attributable to AAR and noncontrolling interest to net cash provided from operating activities:		
Depreciation and intangible amortization	34.9	39.2
Amortization of program development costs	16.5	2.8
Amortization of stock-based compensation	4.1	4.0
Amortization of debt discount	1.4	3.0
Amortization of overhaul costs	10.2	17.5
Deferred tax provision	8.6	9.1
Earnings from joint ventures	(1.3)	(2.0)
Changes in certain assets and liabilities:		
Accounts receivable	(41.5)	(20.8)
Inventories	(48.0)	(4.5)
Rotable spares and equipment on or available for short-term lease	(2.4)	7.3
Equipment on or available for long-term lease	(13.4)	(1.5)
Accounts payable	37.8	(5.9)
Accrued and other liabilities	(9.8)	(15.6)
Other, primarily program and overhaul costs	4.2	(4.3)
Net cash provided from operating activities	31.0	66.3
<b>Cash flows from investing activities:</b>		
Property, plant and equipment expenditures	(17.1)	(14.3)
Proceeds from sale of equipment	1.3	1.4
Other	(1.5)	(0.6)
Net cash used in investing activities	(17.3)	(13.5)
<b>Cash flows from financing activities:</b>		
Short-term borrowings, net	40.0	(20.0)
Reduction in long-term borrowings	(39.5)	(10.4)
Reduction in equity due to convertible bond repurchases	(0.2)	
Reduction in capital lease obligations	(1.5)	
Cash dividends	(6.5)	(6.0)
Purchase of treasury stock	(1.7)	
Stock option exercises	0.2	5.2
Tax benefits from exercise of stock options	0.6	1.0
Other		(0.1)
Net cash used in financing activities	(8.6)	(30.3)
Effect of exchange rate changes on cash	(1.7)	0.7
Increase in cash and cash equivalents	3.4	23.2

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Cash and cash equivalents, beginning of period		89.2		75.3
Cash and cash equivalents, end of period	\$	92.6	\$	98.5

The accompanying Notes to Condensed Consolidated Financial

Statements are an integral part of these statements.

Table of Contents

AAR CORP. and Subsidiaries

Condensed Consolidated Statements of Changes in Equity

For the Six Months Ended November 30, 2014

(Unaudited)

(In millions)

	Common Stock	Capital Surplus	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total AAR Stockholders Equity	Noncontrolling Interest	Total Equity
Balance, May 31, 2014	\$ 44.7	\$ 436.4	\$ 646.0	\$ (98.3)	\$ (29.3)	\$ 999.5	\$ 1.2	\$ 1,000.7
Net income			29.6			29.6	0.1	29.7
Cash dividends			(6.0)			(6.0)	(0.5)	(6.5)
Stock option activity		1.2		0.3		1.5		1.5
Restricted stock activity	0.3	2.4		(0.7)		2.0		2.0
Equity portion of bond repurchase		(0.1)				(0.1)		(0.1)
Repurchase of shares				(1.7)		(1.7)		(1.7)
Other comprehensive loss, net of tax					(23.5)	(23.5)		(23.5)
Balance, November 30, 2014	\$ 45.0	\$ 439.9	\$ 669.6	\$ (100.4)	\$ (52.8)	\$ 1,001.3	\$ 0.8	\$ 1,002.1

The accompanying Notes to Condensed Consolidated Financial

Statements are an integral part of these statements.

# Edgar Filing: AAR CORP - Form 10-Q

## Table of Contents

AAR CORP. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

November 30, 2014

(Unaudited)

(Dollars in millions, except per share amounts)

### **Note 1 Basis of Presentation**

AAR CORP. and its subsidiaries are referred to herein collectively as "AAR," "Company," "we," "us," and "our," unless the context indicates otherwise. The accompanying Condensed Consolidated Financial Statements include the accounts of AAR and its subsidiaries after elimination of intercompany accounts and transactions.

We have prepared these statements without audit, pursuant to the rules and regulations of the United States Securities and Exchange Commission ( "SEC" ). The Condensed Consolidated Balance Sheet as of May 31, 2014 has been derived from audited financial statements. To prepare the financial statements in conformity with U.S. generally accepted accounting principles ( "GAAP" ), management has made a number of estimates and assumptions relating to the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities. Actual results could differ from those estimates. Certain information and note disclosures, normally included in comprehensive financial statements prepared in accordance with GAAP, have been condensed or omitted pursuant to such rules and regulations of the SEC. These Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and notes thereto included in our latest annual report on Form 10-K.

In the opinion of management, the condensed consolidated financial statements reflect all adjustments (which consist only of normal recurring adjustments) necessary to present fairly the condensed consolidated financial position of AAR CORP. and its subsidiaries as of November 30, 2014, the Condensed Consolidated Statements of Income and the Condensed Consolidated Statements of Comprehensive Income for the three- and six-month periods ended November 30, 2014 and 2013, the Condensed Consolidated Statements of Cash Flows for the six-month periods ended November 30, 2014 and 2013, and the Condensed Consolidated Statement of Changes in Equity for the six-month period ended November 30, 2014. The results of operations for such interim periods are not necessarily indicative of the results for the full year.

### **Note 2 Revenue Recognition**

Sales and related cost of sales for product sales are recognized upon shipment of the product to the customer. Our standard terms and conditions provide that title passes to the customer when the product is shipped to the customer. Sales of certain defense products are recognized upon customer acceptance, which includes transfer of title. Under the majority of our expeditionary airlift services contracts, we are paid and record as revenue a fixed daily amount per aircraft for each day an aircraft is available to perform airlift services. In addition, we are paid and record as revenue an amount which is based on number of hours flown. Sales from services and the related cost of services are generally recognized when customer-owned material is shipped back to the customer. We have adopted this accounting policy because at the time the customer-owned material is shipped back to the customer, all services related to that material are complete as our service agreements generally do not require us

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to provide services at customer sites. Furthermore, serviced units are typically shipped to the customer immediately upon completion of the related services. Sales and related cost of sales for certain long-term manufacturing contracts, certain large airframe maintenance contracts, and performance-based logistics programs are recognized by the percentage of completion method, either based on the relationship of costs incurred to date to the estimated total costs or the units of delivery method. Lease revenues are recognized as earned. Income from monthly or quarterly rental payments is recorded in the pertinent period according to the lease agreement. However, for leases that provide variable rents, we recognize lease income on a straight-line basis. In addition to a monthly lease rate, some engine leases require an additional rental amount based on the number of hours the engine is used in a particular month. Lease income associated with these contingent rentals is recorded in the period in which actual usage is reported to us by the lessee, which is normally the month following the actual usage.

Certain supply chain management programs we provide to our customers contain multiple elements or deliverables, such as program and warehouse management, parts distribution, and maintenance and repair services. We recognize revenue for each element or deliverable that can be identified as a separate unit of accounting at the time of delivery based upon the relative fair value of the products and services.

# Edgar Filing: AAR CORP - Form 10-Q

## Table of Contents

AAR CORP. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

November 30, 2014

(Unaudited)

(Dollars in millions, except per share amounts)

Included in accounts receivable as of November 30, 2014 and May 31, 2014, are \$22.1 million and \$19.7 million, respectively, of unbilled accounts receivable related to the KC10 supply agreement. These unbilled accounts receivable relate to costs we have incurred on parts that were requested and accepted by our customer to support the program. These costs have not been billed by us because the customer has not issued the final paperwork necessary to allow for billing.

In addition to the unbilled accounts receivable, included in *Other* non-current assets on the Condensed Consolidated Balance Sheet as of November 30, 2014 and May 31, 2014, are \$8.3 million and \$9.9 million, respectively, of costs in excess of amounts billed for the flight-hour portion of the same KC10 supply agreement. These amounts represent the difference between the amount of revenue recognized by us driven by costs incurred under the flight hour portion of the program, compared to what was billed.

### *New Accounting Pronouncements*

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update ( ASU ) No. 2014-09, *Revenue from Contracts with Customers*, which provides guidance for revenue recognition. This ASU affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of non-financial assets. This ASU will supersede the revenue recognition requirements in ASC 605, Revenue Recognition, and most industry-specific guidance. This ASU will also supersede certain cost guidance included in Subtopic 605-35, Revenue Recognition-Construction-Type and Production-Type Contracts. This new standard will be effective for us beginning June 1, 2017. We are currently evaluating the impact of the adoption of this new standard on our consolidated financial statements.

### **Note 3 Accounting for Stock-Based Compensation**

#### *Restricted Stock*

In July 2014, as part of our annual long-term stock incentive compensation, we granted 192,250 shares of performance-based restricted stock and 95,956 shares of time-based restricted stock to eligible employees. The grant date fair value per share for both grants was \$26.08. In June 2014, we also granted 45,000 shares of time-based restricted stock to members of the Board of Directors with a grant date fair value per share of \$24.50. No restricted stock was granted in the three-month period ended November 30, 2014. Expense charged to operations for restricted stock was \$1.4 million and \$1.4 million during the three months ended November 30, 2014 and 2013, respectively, and \$2.7 million

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and \$2.5 million during the six months ended November 30, 2014 and 2013, respectively.

### *Stock Options*

The total intrinsic value of stock options exercised during the six-month periods ended November 30, 2014 and 2013 was \$1.1 million and \$3.7 million, respectively. Expense charged to operations for stock options was \$0.7 million and \$1.0 million during the three months ended November 30, 2014 and 2013, respectively, and \$1.4 million and \$1.5 million during the six months ended November 30, 2014 and 2013, respectively.

### **Note 4 Inventory**

The summary of inventories is as follows:

	<b>November 30, 2014</b>		<b>May 31, 2014</b>
Raw materials and parts	\$ 105.0	\$	114.1
Work-in-process	66.0		57.5
Aircraft and engine parts, components and finished goods	340.6		297.3
Aircraft held for sale and related support parts	43.2		26.4
	\$ 554.8	\$	495.3



# Edgar Filing: AAR CORP - Form 10-Q

## Table of Contents

### AAR CORP. and Subsidiaries

#### Notes to Condensed Consolidated Financial Statements

November 30, 2014

(Unaudited)

(Dollars in millions, except per share amounts)

We classify certain aircraft from our expeditionary airlift business as assets held for sale at the time management commits to a plan to sell the aircraft, changes to the planned sale are not likely, the aircraft are actively marketed and available for immediate sale, and the sale is expected to be completed within one year. Upon designation of an aircraft as held for sale, we record the aircraft's value at the lower of its carrying value or its estimated fair value, less estimated costs to sell. Assets held for sale are not depreciated.

Aircraft may be classified as assets held for sale for more than one year as we continue to actively market the aircraft at reasonable prices. Certain aircraft types we currently have available for sale are specifically designed for particular functions which limits the marketability of those assets. At November 30, 2014, we had sixteen aircraft held for sale comprised of eight fixed-wing and eight rotary-wing aircraft. At May 31, 2014, we had nine aircraft held for sale comprised of five fixed-wing and four rotary-wing aircraft.

#### **Note 5 Supplemental Cash Flow Information**

	<b>Six Months Ended November 30,</b>	
	<b>2014</b>	<b>2013</b>
Interest paid	\$ 17.3	\$ 17.0
Income taxes paid	8.4	5.6
Income tax refunds received	12.1	6.5

#### **Note 6 Financing Arrangements**

A summary of the carrying amount of our debt is as follows:

	<b>November 30, 2014</b>	<b>May 31, 2014</b>
Revolving credit facility expiring April 24, 2018 with interest payable monthly	\$ 170.0	\$ 130.0
Secured credit facility (secured by aircraft and related engines and components) due April 23, 2015 with floating interest rate, payable monthly	25.3	29.9
	25.0	30.0

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Note payable due March 9, 2017 with floating interest rate, payable semi-annually on June 1 and December 1		
Notes payable due January 15, 2022 with interest at 7.25% payable semi-annually on January 15 and July 15	332.2	332.6
Convertible notes payable due March 1, 2016 with interest at 2.25% payable semi-annually on March 1 and September 1	46.8	45.7
Other(1)	36.0	65.8
Total debt	635.3	634.0
Current maturities of debt	(46.3)	(69.7)
Long-term debt	\$ 589.0	\$ 564.3

(1) Included in Other is a mortgage loan (secured by Wood Dale, Illinois facility) due August 1, 2015 of \$11.0 million and \$11.0 million, 1.75% convertible notes due February 1, 2015 of \$0 and \$29.8 million, and an industrial revenue bond (secured by property, plant, and equipment) due August 1, 2018 of \$25.0 million and \$25.0 million at August 31, 2014 and May 31, 2014, respectively.

At November 30, 2014, the carrying value of our 7.25% bonds and 2.25% convertible notes was \$379.0 million and the estimated fair value was approximately \$402.2 million. These debt issuances are classified as Level 2 in the fair value hierarchy. This classification is defined as a fair value determined using market-based inputs other than quoted prices that are observable for the liability, either directly or indirectly.

# Edgar Filing: AAR CORP - Form 10-Q

## Table of Contents

### AAR CORP. and Subsidiaries

#### Notes to Condensed Consolidated Financial Statements

November 30, 2014

(Unaudited)

(Dollars in millions, except per share amounts)

At November 30, 2014, our remaining variable rate and fixed rate debt had a fair value that approximates the carrying value of \$256.3 million. These debt instruments are classified as Level 3 in the fair value hierarchy, which is defined as a fair value determined based upon one or more significant unobservable inputs.

We are subject to a number of covenants under our financing arrangements, including restrictions that relate to the payment of cash dividends, maintenance of minimum net working capital and tangible net worth levels, fixed charge coverage ratio, sales of assets, additional financing, purchase of our shares and other matters. We are in compliance with all financial and other covenants under our financing arrangements.

#### *Convertible Notes*

During the three-month period ended November 30, 2014, we repurchased all of the outstanding 1.75% convertible notes due February 1, 2015 with a total face value of \$30.0 million for \$31.1 million cash including \$1.1 million of accrued interest.

As of November 30, 2014 and May 31, 2014, the long-term debt and equity component (recorded in capital surplus, net of income tax benefit) for our 2.25% convertible notes consisted of the following:

	November 30, 2014		May 31, 2014
Long-term debt:			
Principal amount	\$ 49.8	\$	49.8
Unamortized discount	(3.0)		(4.1)
Net carrying amount	\$ 46.8	\$	45.7
Equity component, net of tax	\$ 20.6	\$	20.6

The unamortized discount on the liability component of long-term debt is being amortized using the effective interest method based on an effective rate of 7.41% for our 2.25% convertible notes. The if converted value for our 2.25% convertible notes does not exceed its principal amount.

## Edgar Filing: AAR CORP - Form 10-Q

The interest expense associated with all convertible notes was as follows:

	Three Months Ended November 30,				Six Months Ended November 30,			
	2014		2013		2014		2013	
Coupon interest	\$	0.4	\$	0.9	\$	0.9	\$	1.7
Amortization of deferred financing fees				0.1		0.1		0.2
Amortization of discount		0.6		1.5		1.3		2.9
Interest expense related to convertible notes	\$	1.0	\$	2.5	\$	2.3	\$	4.8

### **Note 7 Derivative Instruments and Hedging Activities**

We are exposed to interest rate risk associated with fluctuations in interest rates on our variable rate debt. We utilize two derivative financial instruments to manage our variable interest rate exposure over a medium- to long-term period. We have a floating-to-fixed interest rate swap and an interest rate cap agreement, each hedging \$50.0 million of notional principal interest under our revolving Credit Agreement.

We do not hold or issue derivative instruments for trading purposes and are not a party to any instruments with leverage or prepayment features. In connection with derivative financial instruments, there exists the risk of the possible inability of counterparties to meet the terms of their contracts. We mitigate this risk by performing financial reviews before the contract is entered into, as well as on-going periodic evaluations. We do not expect any significant losses from counterparty defaults.

# Edgar Filing: AAR CORP - Form 10-Q

## Table of Contents

### AAR CORP. and Subsidiaries

#### Notes to Condensed Consolidated Financial Statements

November 30, 2014

(Unaudited)

(Dollars in millions, except per share amounts)

We classify the derivatives as assets or liabilities on the balance sheet. Accounting for the change in fair value of the derivatives is a function of whether the instrument qualifies for, and has been designated as, a hedging relationship, and the type of hedging relationship. As of November 30, 2014, all of our derivative instruments were classified as cash flow hedges. The fair value of the interest rate swap and interest rate cap agreements represents the difference in the present values of cash flows calculated at the contracted interest rates and at current market interest rates at the end of the reporting period.

We record the fair value of assets and liabilities in accordance with the hierarchy established by ASC 820, *Fair Value Measurement*. The fair value of our interest rate derivatives is classified as Level 2, which refers to fair values estimated using significant other observable inputs including quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active. The following table summarizes the classification and fair values of our interest rate derivative instruments reported in the Condensed Consolidated Balance Sheets at November 30, 2014 and May 31, 2014.

<b>Derivatives designated as hedging instruments</b>	<b>Balance Sheet Classification</b>	<b>November 30, 2014</b>		<b>May 31, 2014</b>	
Interest rate cap	Long-term assets	\$	0.1	\$	0.1
Interest rate swap	Long-term liabilities		(2.5)		(2.8)

We include gains and losses on the derivative instruments in other comprehensive income. We recognize the gains and losses on our derivative instruments as an adjustment to interest expense in the period the hedged interest payment affects earnings. The impact of the interest rate swap and interest cap agreement on the Condensed Consolidated Statement of Comprehensive Income for the three-month periods ended November 30, 2014 and 2013 was an unrealized loss of \$0.1 million and \$0.6 million, respectively. The impact of the interest rate swap and interest cap agreement on the Condensed Consolidated Statement of Income for the six-month periods ended November 30, 2014 and 2013 was an unrealized gain of \$0.2 million and \$0.3 million, respectively. The unrealized gains and losses were recorded in accumulated other comprehensive income (loss). We expect minimal gain or loss to be reclassified into earnings within the next 12 months.

#### **Note 8 Earnings per Share**

The computation of basic earnings per share is based on the weighted average number of common shares outstanding during each period. The computation of diluted earnings per share is based on the weighted average number of common shares outstanding during the period plus, when their effect is dilutive, incremental shares consisting of shares subject to stock options, shares issuable upon vesting of restricted stock awards, and shares to be issued upon conversion of convertible debt.

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We used the if converted method in calculating the diluted earnings per share effect of the assumed conversion of our contingently convertible debt because the principal can be settled in stock, cash, or a combination thereof. Under the if converted method, the after-tax effect of interest expense related to the convertible securities is added back to net income, and the convertible debt is assumed to have been converted into common shares at the beginning of the period.

In accordance with ASC 260-10-45, *Share-Based Payment Arrangements and Participating Securities and the Two-Class Method*, our unvested time-based restricted stock awards are deemed participating securities since these shares are entitled to participate in dividends declared on shares of common stock. During periods of net income, the calculation of earnings per share for common stock excludes income attributable to unvested restricted stock awards from the numerator and excludes the dilutive impact of those shares from the denominator. During periods of net loss, no effect is given to the participating securities because they do not share in the losses of the Company.

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## Table of Contents

### AAR CORP. and Subsidiaries

#### Notes to Condensed Consolidated Financial Statements

November 30, 2014

(Unaudited)

(Dollars in millions, except per share amounts)

The following table provides a reconciliation of the computations of basic and diluted earnings per share information for the three- and six-month periods ended November 30, 2014 and 2013.

	Three Months Ended November 30,		Six Months Ended November 30,	
	2014	2013	2014	2013
<i>Basic EPS:</i>				
Net income attributable to AAR and noncontrolling interest	\$ 15.2	\$ 20.0	\$ 29.7	\$ 38.0
Less income attributable to participating shares	(0.3)	(0.4)	(0.6)	(0.8)
Less income attributable to noncontrolling interest			(0.1)	(0.1)
Net income attributable to AAR available to common shareholders	\$ 14.9	\$ 19.6	\$ 29.0	\$ 37.1
<i>Basic shares:</i>				
Weighted average common shares outstanding	38.7	38.6	38.7	38.6
Earnings per share basic	\$ 0.38	\$ 0.51	\$ 0.75	\$ 0.96
<i>Diluted EPS:</i>				
Net income attributable to AAR and noncontrolling interest	\$ 15.2	\$ 20.0	\$ 29.7	\$ 38.0
Less income attributable to participating shares	(0.3)	(0.4)	(0.6)	(0.8)
Less income attributable to noncontrolling interest			(0.1)	(0.1)
Net income attributable to AAR available to common shareholders	\$ 14.9	\$ 19.6	\$ 29.0	\$ 37.1
<i>Diluted shares:</i>				
Weighted average common shares outstanding	38.7	38.6	38.7	38.6
Additional shares from the assumed exercise of stock options	0.4	0.6	0.5	0.5
Weighted average common shares outstanding diluted	39.1	39.2	39.2	39.1
Earnings per share diluted	\$ 0.38	\$ 0.50	\$ 0.74	\$ 0.95

At November 30, 2014 and 2013, respectively, stock options to purchase 185,163 shares and 48,000 shares of common stock were outstanding, but were not included in the computation of diluted earnings per share because the exercise price of each of these options was greater than the average market price of the common shares during the interim periods then ended.





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Table of Contents

AAR CORP. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

November 30, 2014

(Unaudited)

(Dollars in millions, except per share amounts)

**Note 9 Accumulated Other Comprehensive Loss**

Changes in our accumulated other comprehensive loss ( AOCL ) by component for the three- and six-month periods ended November 30, 2014 and 2013 were as follows:

	Currency Translation Adjustments		Pensions Plans		Derivative Instruments		Total
Balance at September 1, 2014	\$ (0.3)	\$	(35.3)	\$	(2.3)	\$	(37.9)
Other comprehensive loss before reclassifications	(14.8)				(0.1)		(14.9)
Amounts reclassified from AOCL							
Total other comprehensive loss	(14.8)				(0.1)		(14.9)
Balance at November 30, 2014	\$ (15.1)	\$	(35.3)	\$	(2.4)	\$	(52.8)
Balance at September 1, 2013	\$ (2.6)	\$	(33.6)	\$	(2.4)	\$	(38.6)
Other comprehensive income (loss) before reclassifications	9.0				(0.6)		8.4
Amounts reclassified from AOCL			0.3				0.3
Total other comprehensive income (loss)	9.0		0.3		(0.6)		8.7
Balance at November 30, 2013	\$ 6.4	\$	(33.3)	\$	(3.0)	\$	(29.9)

	Currency Translation Adjustments		Pensions Plans		Derivative Instruments		Total
Balance at June 1, 2014	\$ 8.7	\$	(35.4)	\$	(2.6)	\$	(29.3)
Other comprehensive income (loss) before reclassifications	(23.8)				0.2		(23.6)
Amounts reclassified from AOCL			0.1				0.1
Total other comprehensive income (loss)	(23.8)		0.1		0.2		(23.5)
Balance at November 30, 2014	\$ (15.1)	\$	(35.3)	\$	(2.4)	\$	(52.8)
Balance at June 1, 2013	\$ (5.4)	\$	(33.8)	\$	(3.3)	\$	(42.5)
Other comprehensive income before reclassifications	11.8				0.3		12.1
Amounts reclassified from AOCL			0.5				0.5
Total other comprehensive income	11.8		0.5		0.3		12.6
Balance at November 30, 2013	\$ 6.4	\$	(33.3)	\$	(3.0)	\$	(29.9)

**Note 10 Program Development Costs**

Our Cargo Systems unit was selected in June 2005 to provide cargo loading systems for the Airbus A400M Military Transport Aircraft ( A400M ). During fiscal 2013, we delivered initial production units to Airbus and began delivering revenue-producing units in fiscal 2014. As of November 30, 2014 and May 31, 2014, we have capitalized, net of reimbursements and amortization, \$128.5 million and \$139.8 million, respectively, of costs associated with the engineering and development of the cargo system. Capitalized costs are classified between current and non-current assets on the Condensed Consolidated Balance Sheets. Current assets include \$44.2 million and \$27.6 million in *Deposits, prepaids and other* at November 30, 2014 and May 31, 2014, respectively, and non-current assets include \$84.3 million and \$112.2 million in *Capitalized program development costs* at November 30, 2014 and May 31, 2014, respectively.

# Edgar Filing: AAR CORP - Form 10-Q

## Table of Contents

AAR CORP. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

November 30, 2014

(Unaudited)

(Dollars in millions, except per share amounts)

Sales and related cost of sales are recognized on the units of delivery method. Amortization expense for program development costs was \$13.8 million and \$2.1 million during the three months ended November 30, 2014 and 2013, respectively, and \$16.5 million and \$2.8 million during the six months ended November 30, 2014 and 2013, respectively.

In determining the recoverability of the capitalized program development costs, we have made certain judgments and estimates concerning expected revenues and the cost to manufacture the A400M cargo system. Differences between actual results and our assumptions may result in our not fully recovering our program development costs, which could adversely affect our operating results and financial condition.

### **Note 11 Business Segment Information**

Consistent with how our chief operating decision making officer (Chief Executive Officer) evaluates performance and the way we are organized internally, we report our activities in two business segments: Aviation Services and Technology Products.

Sales in the Aviation Services segment are derived from the sale and lease of a wide variety of new, overhauled and repaired engine and airframe parts and components to the commercial aviation and government and defense markets. We provide customized inventory supply chain management, performance based logistics programs, aircraft component repair management services, and aircraft modifications. The segment also includes repair, maintenance and overhaul of aircraft and landing gear and expeditionary airlift services. Cost of sales consists principally of the cost of product, direct labor, overhead, and aircraft maintenance costs.

Sales in the Technology Products segment are derived from the manufacture of heavy-duty pallets and lightweight cargo containers for the commercial market, in-plane cargo loading and handling systems for commercial and military applications, and steel and composite machined and fabricated parts, components and sub-systems for various aerospace and defense programs. The segment also engineers, designs and manufactures containers, pallets and shelters used to support the U.S. military's requirements for a mobile and agile force and provides system integration services for specialized command and control systems. Cost of sales consists principally of the cost of material to manufacture products, direct labor and overhead.

The accounting policies for the segments are the same as those described in Note 1 of Notes to Consolidated Financial Statements included in our annual report on Form 10-K for the year ended May 31, 2014. Our Chief Executive Officer evaluates performance based on the reportable

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segments and utilizes gross profit as a primary profitability measure. Gross profit is calculated by subtracting cost of sales from sales. The assets and certain expenses related to corporate activities are not allocated to the segments. Our reportable segments are aligned principally around differences in products and services.

# Edgar Filing: AAR CORP - Form 10-Q

## Table of Contents

### AAR CORP. and Subsidiaries

#### Notes to Condensed Consolidated Financial Statements

November 30, 2014

(Unaudited)

(Dollars in millions, except per share amounts)

Selected financial information for each segment is as follows:

	Three Months Ended November 30,		Six Months Ended November 30,	
	2014	2013	2014	2013
<b>Sales:</b>				
Aviation Services	\$ 377.7	\$ 424.7	\$ 741.4	\$ 818.4
Technology Products	112.3	116.0	217.8	236.8
	\$ 490.0	\$ 540.7	\$ 959.2	\$ 1,055.2

	Three Months Ended November 30,		Six Months Ended November 30,	
	2014	2013	2014	2013
<b>Gross profit:</b>				
Aviation Services	\$ 63.9	\$ 71.3	\$ 123.0	\$ 136.8
Technology Products	14.6	19.7	30.8	38.9
	\$ 78.5	\$ 91.0	\$ 153.8	\$ 175.7

The following table reconciles segment gross profit to consolidated income before provision for income taxes.

	Three Months Ended November 30,		Six Months Ended November 30,	
	2014	2013	2014	2013
Segment gross profit	\$ 78.5	\$ 91.0	\$ 153.8	\$ 175.7
Selling, general and administrative	(47.1)	(51.1)	(92.0)	(98.8)
Earnings from joint ventures	0.7	0.8	1.3	2.0
Interest expense	(9.6)	(10.5)	(19.2)	(21.5)
Interest income	0.1	0.3	0.2	0.6
Income before provision for income taxes	\$ 22.6	\$ 30.5	\$ 44.1	\$ 58.0

Table of Contents

**Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations**

**(Dollars in millions)**

**General Overview**

We report our activities in two business segments: Aviation Services and Technology Products.

The Aviation Services segment provides aftermarket support and services and includes the sale and lease of a wide variety of new, overhauled and repaired engine and airframe parts and components to the commercial aviation and government and defense markets. We provide customized inventory supply chain management, performance based logistics programs, aircraft component repair management services, and aircraft modifications. The segment also includes repair, maintenance and overhaul of aircraft and landing gear and expeditionary airlift services. Cost of sales consists principally of the cost of product, direct labor, overhead, and aircraft maintenance costs.

Sales in the Technology Products segment are derived from the manufacture of heavy-duty pallets and lightweight cargo containers for the commercial market, in-plane cargo loading and handling systems for commercial and military applications, and steel and composite machined and fabricated parts, components and sub-systems for various aerospace and defense programs. The segment also engineers, designs and manufactures containers, pallets and shelters used to support the U.S. military's requirements for a mobile and agile force and provides system integration services for specialized command and control systems. Cost of sales consists principally of the cost of material to manufacture products, direct labor and overhead.

The accounting policies for the segments are the same as those described in Note 1 of Notes to Consolidated Financial Statements included in our annual report on Form 10-K for the year ended May 31, 2014. Our chief operating decision making officer (Chief Executive Officer) evaluates performance based on the reportable segments and utilizes gross profit as a primary profitability measure. Gross profit is calculated by subtracting cost of sales from sales. The assets and certain expenses related to corporate activities are not allocated to the segments. Our reportable segments are aligned principally around differences in products and services.

Consolidated sales for the first six months of fiscal 2015 decreased \$96.0 million or 9.1% compared to the prior year period. Sales to government and defense customers decreased \$109.9 million or 24.5% compared to the prior year driven primarily by lower demand by the U.S. Department of Defense ( DoD ) for expeditionary airlift services in Afghanistan as a result of the reduction in U.S. troops in Afghanistan. The prior year results also were enhanced by the delivery of three aircraft to government customers in fiscal 2014 as compared to no deliveries in fiscal 2015.

The DoD's reduced role in Afghanistan as a result of the troop drawn-down has had a significant impact on our expeditionary airlift fleet operations in Afghanistan. At the beginning of fiscal 2014, we had 40 aircraft in revenue service compared to 17 aircraft in revenue service as of November 30, 2014. We are actively marketing 16 aircraft for sale comprised of 8 rotary-wing and 8 fixed-wing aircraft. Additional aircraft may be available for sale should existing aircraft not be utilized on new contract awards.

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During the first six months of fiscal 2015, sales to commercial customers increased \$13.9 million or 2.3% compared to the prior year driven primarily by higher supply chain volumes and strong demand for aftermarket parts support. These increases were partially offset by a significant engineering services program that ended in the second quarter of fiscal 2014 and lower volumes in maintenance, repair and overhaul services.

Table of Contents**Results of Operations**

Sales and gross profit for our two business segments for the three- and six months ended November 30, 2014 and 2013 were as follows:

	Three Months Ended November 30,			Six Months Ended November 30,		
	2014	2013	% Change	2014	2013	% Change
<b>Sales:</b>						
Aviation Services						
Commercial	\$ 247.6	\$ 242.7	2.0%	\$ 484.6	\$ 464.1	4.4%
Defense	130.1	182.0	(28.5)%	256.8	354.3	(27.5)%
	\$ 377.7	\$ 424.7	(11.1)%	\$ 741.4	\$ 818.4	(9.4)%
Technology Products						
Commercial	\$ 69.6	\$ 67.8	2.7%	\$ 135.6	\$ 142.2	(4.6)%
Defense	42.7	48.2	(11.4)%	82.2	94.6	(13.1)%
	\$ 112.3	\$ 116.0	(3.2)%	\$ 217.8	\$ 236.8	(8.0)%

	Three Months Ended November 30,			Six Months Ended November 30,		
	2014	2013	% Change	2014	2013	% Change
<b>Gross Profit:</b>						
Aviation Services						
Commercial	\$ 41.1	\$ 35.8	14.8%	\$ 77.8	\$ 71.1	9.4%
Defense	22.8	35.5	(35.8)%	45.2	65.7	(31.2)%
	\$ 63.9	\$ 71.3	(10.4)%	\$ 123.0	\$ 136.8	(10.1)%
Technology Products						
Commercial	\$ 13.3	\$ 16.3	(18.4)%	\$ 27.5	\$ 31.1	(11.6)%
Defense	1.3	3.4	(61.8)%	3.3	7.8	(57.7)%
	\$ 14.6	\$ 19.7	(25.9)%	\$ 30.8	\$ 38.9	(20.8)%

**Three-Month Period Ended November 30, 2014***Aviation Services Segment*

For the three-month period ended November 30, 2014, sales in the Aviation Services segment decreased \$47.0 million or 11.1% from the prior year period. The decrease in sales was due to a \$51.9 million or 28.5% decrease in sales to government and defense customers primarily attributable to lower demand for expeditionary airlift services in Afghanistan due to a reduced number of aircraft positions and the delivery of two aircraft to the U.S. Marshals Service in the second quarter of fiscal 2014 with no deliveries in fiscal 2015. These decreases were partially offset by stronger volumes in our defense logistics business.

Sales in this segment to commercial customers increased \$4.9 million or 2.0% over the prior year primarily attributable to higher supply chain volumes due principally to new contract wins announced in the second half of fiscal 2014. This increase was partially offset by lower volumes



in maintenance, repair and overhaul services.

Gross profit for the second quarter ended November 30, 2014 in the Aviation Services segment decreased \$7.4 million or 10.4%. Gross profit on sales to commercial customers increased \$5.3 million or 14.8% over the prior year with the gross profit margin increased to 16.6% compared to 14.8% in the prior year. The increase in gross profit on sales to commercial customers is primarily attributable to higher supply chain volumes and higher demand for aftermarket parts support.

Table of Contents

Gross profit in this segment on sales to government and defense customers decreased \$12.7 million or 35.8% from the prior year due to fewer contracted positions in Afghanistan for our expeditionary airlift business partially offset by stronger volumes in our defense logistics business. The decrease in our gross profit margin from 19.5% to 17.5% was primarily attributable to the reduction in contracted positions of our higher-margin expeditionary airlift services in Afghanistan.

*Technology Products Segment*

For the three-month period ended November 30, 2014, sales in the Technology Products segment decreased \$3.7 million or 3.2% from the prior year period. The decrease in sales was due to a \$5.5 million or 11.4% decrease in sales to our government and defense customers primarily attributable to lower demand for mobility products and precision-machined parts. These decreases were partially offset by increased sales of cargo loading system components for the Airbus A400M Military Transport Aircraft ( A400M ).

Sales in this segment to our commercial customers increased \$1.8 million or 2.7% primarily attributable to greater demand for cargo containers.

Gross profit for the second quarter ended November 30, 2014 in the Technology Products segment decreased \$5.1 million or 25.9%. Gross profit on sales to commercial customers decreased \$3.0 million or 18.4% from the prior year with the gross profit margin decreasing to 19.1% in fiscal 2015 from 24.0% in the prior year. The decrease in gross profit was primarily attributable to lower demand for precision-machined parts with an unfavorable product mix across cargo systems and spares contributing to the decline in gross profit margin.

Gross profit in this segment on sales to government and defense customers decreased \$2.1 million or 61.8% from the prior year with the gross profit margin decreasing to 3.0% in fiscal 2015 from 7.1% in the prior year. The decreased gross profit on sales to government and defense customers is primarily attributable to lower sales volumes at our mobility products business, as well as increased sales of the low-margin A400M cargo system.

*Selling, General and Administrative Expenses and Earnings from Aircraft Joint Ventures*

Selling, general and administrative expenses decreased \$4.0 million in the second quarter ended November 30, 2014 from the prior year period reflecting the realization of benefits from the cost control measures implemented by the Company during fiscal 2014. These measures included the elimination of certain positions and favorable procurement actions.

Earnings from aircraft joint ventures decreased \$0.1 million reflecting lower lease revenue from our joint ventures.

*Operating and Net Income*

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Operating income decreased \$8.6 million or 21.1% from the prior year primarily due to the impact of lower sales in each of our reportable segments, partially offset by the favorable impact of lower selling, general and administrative expenses.

Our effective income tax rate was 32.7% for the quarter ended November 30, 2014 compared to 34.4% in the prior year period. This lower effective tax rate reflects the expected increase in manufacturing incentives in fiscal 2015, which had previously been limited as a result of tax losses and the utilization of tax losses.

Net income was \$15.2 million compared to \$20.0 million in the prior year due to the factors discussed above.

Table of Contents

**Six-Month Period Ended November 30, 2014**

*Aviation Services Segment*

For the six-month period ended November 30, 2014, sales in the Aviation Services segment decreased \$77.0 million or 9.4% from the prior year period. The decrease in sales was due to a \$97.5 million or 27.5% decrease in sales to government and defense customers primarily attributable to lower demand for expeditionary airlift services in Afghanistan due to a reduced number of aircraft positions, and the delivery of three aircraft to government customers in fiscal 2014 with no deliveries in the first six months of fiscal 2015. These decreases were partially offset by higher supply chain volumes.

Sales in this segment to commercial customers increased \$20.5 million or 4.4% over the prior year primarily due to higher supply chain volumes due principally to new contract wins announced in the second half of fiscal 2014 and higher demand for aftermarket parts support. These increases were partially offset by a significant engineering services program that ended in the second quarter of fiscal 2014 as well as lower volumes in maintenance, repair and overhaul activity.

Gross profit in the Aviation Services segment decreased \$13.8 million or 10.1%. Gross profit on sales to commercial customers increased \$6.7 million or 9.4% over the prior year with the gross profit margin increasing to 16.1% compared to 15.3% in the prior year. The increase in gross profit on sales to commercial customers is primarily attributable to higher supply chain volumes. This increase was partially offset by a slight decline in gross profit margins in our maintenance, repair and overhaul businesses.

Gross profit in this segment on sales to government and defense customers decreased \$20.5 million or 31.2% from the prior year due to fewer contracted positions in Afghanistan for our expeditionary airlift business. The decrease in our gross profit margin from 18.5% to 17.6% was also attributable to the reduction in contracted positions of our higher-margin expeditionary airlift services in Afghanistan.

*Technology Products Segment*

For the six-month period ended November 30, 2014, sales in the Technology Products segment decreased \$19.0 million or 8.0% from the prior year period. The decrease in sales was due to a \$12.4 million or 13.1% decline in sales to our government and defense customers due to lower demand for our mobility products and precision-machined parts. These decreases were partially offset by increased sales of our A400M cargo loading system components.

Sales in this segment to our commercial customers decreased \$6.6 million or 4.6% primarily attributable to lower demand for our precision-machined parts and cargo systems.

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Gross profit in the Technology Products segment decreased \$8.1 million or 20.8%. Gross profit on sales to commercial customers decreased \$3.6 million or 11.6% from the prior year with the gross profit margin decreasing to 20.3% in fiscal 2015 from 21.9% in the prior year. The decrease in gross profit was primarily attributable to unfavorable product mix within our cargo business.

Gross profit in this segment on sales to government and defense customers decreased \$4.5 million or 57.7% from the prior year with the gross profit margin decreasing to 4.0% in fiscal 2015 from 8.2% in the prior year. The decreased gross profit on sales to government and defense customers is primarily attributable to lower sales volumes at our mobility products business, as well as increased sales of the low-margin A400M cargo system.

### *Selling, General and Administrative Expenses and Earnings from Aircraft Joint Ventures*

Selling, general and administrative expenses decreased \$6.8 million in fiscal 2015 reflecting the realization of benefits from the cost control measures implemented by the Company during fiscal 2014, including the elimination of certain positions and favorable procurement actions.

Earnings from aircraft joint ventures decreased \$0.7 million reflecting lower lease revenue from our joint ventures.

Table of Contents

*Operating and Net Income*

Operating income decreased \$15.8 million or 20.0% from the prior year primarily due to the impact of lower sales in each of our reportable segments, partially offset by the favorable impact of lower selling, general and administrative expenses.

Our effective income tax rate was 32.7% for the six-month period ended November 30, 2014 compared to 34.5% in the prior year period. This lower effective tax rate reflects the expected increase in manufacturing incentives in fiscal 2015, which had previously been limited as a result of tax losses and the utilization of tax losses.

Net income was \$29.6 million compared to \$37.9 million in the prior year due to the factors discussed above.

**Liquidity, Capital Resources and Financial Position**

Our operating activities are funded and commitments met principally through the generation of cash from operations. Periodically, we may raise capital through the issuance of common stock or debt in the public and private markets. In addition to these cash sources, our current capital resources include an unsecured credit facility, as well as a separate secured credit facility. We continually evaluate various financing arrangements, including the issuance of common stock or debt, which would allow us to improve our liquidity position and finance future growth on commercially reasonable terms. Our continuing ability to borrow from our lenders and issue debt and equity securities to the public and private markets in the future may be negatively affected by a number of factors, including the overall health of the credit markets, general economic conditions, airline industry conditions, geo-political events, and our operating performance. Our ability to generate cash from operations is influenced primarily by our operating performance and changes in working capital. Under our universal shelf registration statement filed with the Securities and Exchange Commission that became effective May 4, 2012, we registered an indeterminate number of principal amount or shares of common stock, shares of preferred stock, debt securities, warrants, stock purchase contracts and stock purchase units which may be sold from time to time, subject to market conditions.

At November 30, 2014, our liquidity and capital resources included cash of \$92.6 million and working capital of \$814.9 million. We have an agreement with various financial institutions, as lenders, and Bank of America, N.A., as administrative agent for the lenders (as amended, the Credit Agreement ) providing for an unsecured revolving credit facility of \$475.0 million that we can draw upon for general corporate purposes. The Credit Agreement expires on April 24, 2018. Borrowings under the Credit Agreement bear interest at the offered Eurodollar Rate (defined as the British Bankers Association LIBOR Rate) plus 125 to 225 basis points based on certain financial measurements if a Eurodollar Rate loan, or at the offered fluctuating Base Rate plus 25 to 125 basis points based on certain financial measurements if a Base Rate loan. Borrowings outstanding under this facility at November 30, 2014 were \$170.0 million and there were approximately \$15.0 million of outstanding letters of credit, which reduced the availability of this facility to \$290.0 million. There are no other terms or covenants limiting the availability of this facility. We also have \$5.1 million available under a foreign line of credit.

In addition to our unsecured Credit Agreement, we have a \$40.0 million secured term credit facility with The Huntington National Bank (the Huntington Loan Agreement ). Borrowings under the Huntington Loan Agreement are secured by aircraft and related engines and components owned by us. The Huntington Loan Agreement expires on April 23, 2015. Borrowings bear interest at LIBOR plus 175 basis points. As of November 30, 2014, \$25.3 million was outstanding under this agreement.

We intend to retire maturities due within the next 12 months through a combination of cash on hand and borrowings under our Credit Agreement.

We are in compliance with all financial and other covenants under each of our financing arrangements.

*Cash Flows from Operating Activities*

During the six-month period ended November 30, 2014, our cash flow from operations was \$30.8 million primarily as a result of net income attributable to AAR and noncontrolling interest, depreciation and amortization, and an increase in accounts payable. These positive impacts were partially offset by increases in accounts receivable and inventory as well as additional investments in equipment on or available for long-term lease.

Table of Contents

During the six-month period ended November 30, 2014, cash flow from operations decreased \$35.5 million from the six-month period ended November 30, 2013 primarily due to increased working capital related to the new supply chain contract wins announced in the second half of fiscal 2014.

*Cash Flows from Investing Activities*

During the six-month period ended November 30, 2014, our investing activities used \$17.1 million of cash principally due to property, plant and equipment expenditures.

During the six-month period ended November 30, 2014, cash flows used in investing activities increased \$3.6 million over the six-month period ended November 30, 2013 due to increased spend on property, plant and equipment in fiscal 2015.

*Cash Flows from Financing Activities*

During the six-month period ended November 30, 2014, our financing activities used \$8.6 million of cash primarily due to reduction in borrowings, which consist primarily of the early retirement of the 1.75% convertible notes for \$30.0 million, and the payment of dividends, partially offset by additional borrowings on our revolving credit facility.

During the six-month period ended November 30, 2014, cash flows used in financing activities decreased \$21.7 million over the six-month period ended November 30, 2013 primarily due from additional borrowings on our revolving credit facility.

**Critical Accounting Policies and Significant Estimates**

We make a number of significant estimates, assumptions and judgments in the preparation of our financial statements. See *Management's Discussion and Analysis of Financial Condition and Results of Operations* in our 2014 Form 10-K for a discussion of our critical accounting policies. There have been no significant changes to the application of our critical accounting policies during the second quarter of fiscal 2015.

**Forward-Looking Statements**

This report contains certain forward-looking statements as that term is defined in the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on beliefs of our management, as well as assumptions and estimates based on information available to us as of the dates such assumptions and estimates are made, and are subject to certain risks and uncertainties that could cause actual results to differ



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materially from historical results or those anticipated, depending on a variety of factors, including those factors set forth under Part I, Item 1A in our Annual Report on Form 10-K for the year ended May 31, 2014 and in our Quarterly Report on Form 10-Q for the quarterly period ended August 31, 2014. Should one or more of those risks or uncertainties materialize adversely, or should underlying assumptions or estimates prove incorrect, actual results may vary materially from those described. Those events and uncertainties are difficult or impossible to predict accurately and many are beyond our control. We assume no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

### **Item 3 Quantitative and Qualitative Disclosures About Market Risk**

Our exposure to market risk includes fluctuating interest rates under our credit agreements and changes in foreign exchange rates.

*Foreign Currency Risk.* Revenues and expenses of our foreign operations are translated at average exchange rates during the period, and balance sheet accounts are translated at period-end exchange rates. Balance sheet translation adjustments are excluded from the results of operations and are recorded in stockholders' equity as a component of accumulated other comprehensive loss. A hypothetical 10 percent devaluation of the U.S. dollar against foreign currencies would have decreased pre-tax income by approximately \$3 million during the three-month period ended November 30, 2014.

*Interest Rate Risk.* Refer to the section Quantitative and Qualitative Disclosures about Market Risk in our Annual Report on Form 10-K for the year ended May 31, 2014. There were no significant changes during the quarter ended November 30, 2014.

Table of Contents

**Item 4 Controls and Procedures**

As required by Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of November 30, 2014. This evaluation was carried out under the supervision and with participation of our Chief Executive Officer and Chief Financial Officer. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures. Therefore, effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. Based upon our evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective as of November 30, 2014, ensuring that information required to be disclosed in the reports that are filed under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported in a timely manner.

There were no changes in our internal control over financial reporting during the second quarter ended November 30, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents**PART II OTHER INFORMATION****Item 1A Risk Factors**

There have been no material changes to our risk factors as set forth in our Annual Report on Form 10-K for the year ended May 31, 2014 and our Quarterly Report on Form 10-Q for the quarter ended August 31, 2014.

**Item 2 Unregistered Sales of Equity Securities and Use of Proceeds**

(Dollars in thousands, except per share data)

(c) The following table provides information about purchases we made during the quarter ended November 30, 2014 of equity securities that are registered by us pursuant to Section 12 of the Exchange Act:

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share (1)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (2)
9/1/2014 9/30/2014	8,280	\$ 24.30		
10/1/2014 10/31/2014	70,000	\$ 23.88	70,000	
11/1/2014 11/30/2014				
Total	78,280	\$ 23.92	70,000	\$ 34,360,495

(1) These amounts include share repurchases pursuant to our stock repurchase plan and shares repurchased related to restricted stock grants.

(2) Our common stock repurchase plan was approved by our Board of Directors on June 14, 2012. As of November 30, 2014, \$34.4 million of the original \$50.0 million of our outstanding shares of Common Stock was still available for repurchase on the open market or in private transactions. This program does not have an expiration date.

**Item 6 Exhibits**

The exhibits to this report are listed on the Exhibit Index included elsewhere herein. Management contracts and compensatory arrangements, if any, have been marked with an asterisk (\*) on the Exhibit Index.



Table of Contents

SIGNATURE

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

AAR CORP.  
(Registrant)

Date: December 19, 2014

/s/ JOHN C. FORTSON  
John C. Fortson  
*Vice President, Chief Financial Officer and Treasurer*  
(Principal Financial Officer and officer duly  
authorized to sign on behalf of registrant)

/s/ MICHAEL J. SHARP  
Michael J. Sharp  
*Vice President, Controller and Chief Accounting Officer*  
(Principal Accounting Officer)

Table of ContentsEXHIBIT INDEX

Exhibit No.	Description	Exhibits
31.	Rule 13a-14(a)/15(d)-14(a) Certifications	<p>31.1 Section 302 Certification dated December 19, 2014 of David P. Storch, Chairman and Chief Executive Officer of Registrant (filed herewith).</p> <p>31.2 Section 302 Certification dated December 19, 2014 of John C. Fortson, Vice President, Chief Financial Officer and Treasurer of Registrant (filed herewith).</p>
32.	Section 1350 Certifications	<p>32.1 Section 906 Certification dated December 19, 2014 of David P. Storch, Chairman and Chief Executive Officer of Registrant (filed herewith).</p> <p>32.2 Section 906 Certification dated December 19, 2014 of John C. Fortson, Vice President, Chief Financial Officer and Treasurer of Registrant (filed herewith).</p>
101.	Interactive Data File	<p>101 The following materials from the Registrant's Quarterly Report on Form 10-Q for the quarter ended November 30, 2014, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets at November 30, 2014 and May 31, 2014, (ii) Condensed Consolidated Statements of Income for the three and six months ended November 30, 2014 and 2013, (iii) Condensed Consolidated Statements of Comprehensive Income for the three and six months ended November 30, 2014 and 2013, (iv) Condensed Consolidated Statements of Cash Flows for the six months ended November 30, 2014 and 2013, (v) Condensed Consolidated Statement of Changes in Equity for the six months ended November 30, 2014 and (vi) Notes to Condensed Consolidated Financial Statements.**</p>

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\*\* Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.