

AAR CORP
Form 10-K
July 15, 2015

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[TABLE OF CONTENTS](#)

[PART IV](#)

[Table of Contents](#)

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended May 31, 2015

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission file number 1-6263

AAR CORP.

(Exact name of registrant as specified in its charter)

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 60191

(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: **(630) 227-2000**

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class
Common Stock, \$1.00 par value

Name of Each Exchange on Which Registered
**New York Stock Exchange
Chicago Stock Exchange**

Common Stock Purchase Rights

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**New York Stock Exchange
Chicago Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.(Check one):

Large accelerated filer

Accelerated filer

Non-Accelerated filer

Smaller reporting company

(Do not check if a
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

The aggregate market value of the registrant's voting stock held by nonaffiliates was approximately \$962 million (based upon the closing price of the Common Stock at November 28, 2014 as reported on the New York Stock Exchange).

On June 30, 2015, there were 35,366,407 shares of Common Stock outstanding.

Documents Incorporated by Reference

Portions of the Company's proxy statement for the Company's 2015 Annual Meeting of Stockholders, to be held October 13, 2015, are incorporated by reference in Part III of this report.

Table of Contents**TABLE OF CONTENTS**

	Page
<u>PART I</u>	
<u>Item 1.</u> <u>Business</u>	<u>2</u>
<u>Item 1A.</u> <u>Risk Factors</u>	<u>7</u>
<u>Item 1B.</u> <u>Unresolved Staff Comments</u>	<u>13</u>
<u>Item 2.</u> <u>Properties</u>	<u>13</u>
<u>Item 3.</u> <u>Legal Proceedings</u>	<u>14</u>
<u>Item 4.</u> <u>Mine Safety Disclosures</u>	<u>14</u>
	<u>14</u>
	<u>14</u>
<u>Supplemental Item</u> <u>Executive Officers of the Registrant</u>	<u>14</u>
<u>PART II</u>	
<u>Item 5.</u> <u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	<u>16</u>
<u>Item 6.</u> <u>Selected Financial Data</u>	<u>18</u>
<u>Item 7.</u> <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>20</u>
<u>Item 7A.</u> <u>Quantitative and Qualitative Disclosures about Market Risk</u>	<u>33</u>
<u>Item 8.</u> <u>Financial Statements and Supplementary Data</u>	<u>34</u>
<u>Item 9.</u> <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	<u>77</u>
<u>Item 9A.</u> <u>Controls and Procedures</u>	<u>77</u>
<u>Item 9B.</u> <u>Other Information</u>	<u>79</u>
<u>PART III</u>	
<u>Item 10.</u> <u>Directors, Executive Officers and Corporate Governance</u>	<u>79</u>
<u>Item 11.</u> <u>Executive Compensation</u>	<u>79</u>
<u>Item 12.</u> <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	<u>80</u>
<u>Item 13.</u> <u>Certain Relationships and Related Transactions, and Director Independence</u>	<u>80</u>
<u>Item 14.</u> <u>Principal Accountant Fees and Services</u>	<u>80</u>
<u>PART IV</u>	
<u>Item 15.</u> <u>Exhibits and Financial Statement Schedules</u>	<u>81</u>
<u>SIGNATURES</u>	<u>82</u>
<u>EXHIBIT INDEX</u>	

Table of Contents

PART I

ITEM 1. BUSINESS
(Dollars in millions)

General

AAR CORP. and its subsidiaries are referred to herein collectively as "AAR," "Company," "we," "us," and "our" unless the context indicates otherwise. AAR was founded in 1951, organized in 1955 and reincorporated in Delaware in 1966. We are a diversified provider of products and services to the worldwide aviation and government and defense markets.

Upon completing our annual strategic review process and assessing our markets, we entered fiscal 2015 with a mission to narrow our focus, excel as an independent services provider to the global commercial aviation and government and defense markets, strengthen our balance sheet, and improve shareholder return. The comprehensive plan included exploring selling certain manufacturing businesses and as the year progressed included a review of our underperforming product lines and inventories in our services businesses to determine which product areas to focus on going forward. The first phase of this transformation included the sale of the Telair Cargo Group for \$725 million in the fourth quarter of fiscal 2015 which resulted in a pre-tax gain (net of transaction expenses and fees) of \$198.6 million. The gain excludes \$35 million of contingent consideration which could be realized prior to December 31, 2015. Our plans further called for us to sell our Precision Systems Manufacturing ("PSM") business, comprised of our metal and composite machined and fabricated parts manufacturing operations. During fiscal 2015, we recognized total impairment charges of \$57.5 million to reduce the carrying value of PSM's net assets to their expected value at time of sale.

The product lines and inventories identified as underperforming or not part of our strategy going forward in our services businesses included certain aircraft in our aircraft lease portfolio, inventory and rotatable assets in our supply chain and maintenance, repair and overhaul ("MRO") operations, and certain aircraft and inventory in our expeditionary airlift business. We recognized \$71.4 million in impairment charges and other losses in fiscal 2015 from these actions while at the same time generating approximately \$57.1 million of cash.

By executing this plan, we strengthened our balance sheet and returned capital to shareholders. Using the proceeds from the sale of the Telair Cargo Group and other assets, we reduced our total debt from \$634.0 million at May 31, 2014 to \$154.0 million at May 31, 2015. Taking into consideration cash on hand, our net debt position at May 31, 2015 is \$99.3 million. In addition, we acquired 4,682,620 of our common shares during fiscal 2015 for an aggregate cost of \$151.5 million, and paid \$12.5 million in dividends.

As we enter fiscal 2016, we find ourselves in a strong financial position to build out our strategy as a best in class aviation and expeditionary services company. Our cash on hand plus unused capacity on our Credit Agreement is \$490 million at May 31, 2015. We expect to invest opportunistically in expanding our comprehensive suite of services to the global commercial aviation and government and defense markets.

Prior to the third quarter of fiscal 2015, we reported our activities in the following two business segments: *Aviation Services* comprised of our supply chain, MRO, and airlift activities and *Technology Products* comprised of our Telair Cargo Group, Precision Systems Manufacturing, and mobility businesses.

With the decisions to sell Telair Cargo Group and PSM in the third quarter of fiscal 2015, we reported those businesses as discontinued operations for all periods presented. We also revised our reportable segments to align to our new organizational structure. We now report our results in two new segments: *Aviation Services*, comprised of supply chain and MRO activities and *Expeditionary Services*, comprised of airlift and mobility activities. This new presentation reflects the way our chief operating decision making officer (Chief Executive Officer) now evaluates performance and our internal organizational and management structure.

Table of Contents

Business Segments

Aviation Services

The Aviation Services segment provides aftermarket support and services for the commercial aviation and government and defense markets and accounted for 83%, 72%, and 69% of our sales in fiscal 2015, 2014, and 2013, respectively. In this segment, we also provide inventory management and distribution services, MRO, and engineering services. Business activities in this segment are primarily conducted through AAR Parts Trading, Inc.; AAR Aircraft & Engine Sales & Leasing, Inc.; AAR Aircraft Services, Inc.; AAR Allen Services, Inc. (a wholly-owned subsidiary of AAR Parts Trading, Inc.); AAR Landing Gear LLC; and AAR International, Inc.

We sell and lease a wide variety of new, overhauled and repaired engine and airframe parts and components to our commercial aviation and government/defense customers.

We provide customized inventory supply and management, warranty claim management, and outsourcing programs for engine and airframe parts and components in support of our airline and government customers' maintenance activities. The types of services provided under these programs include material planning, sourcing, logistics, information and program management, and parts and component repair and overhaul. We are also an authorized distributor for more than 60 leading aviation product manufacturers.

We also provide customized performance-based logistics programs in support of the U.S. Department of Defense ("DoD") and foreign governments. The types of services provided under these programs include material planning, sourcing, logistics, information and program management, airframe maintenance and maintenance planning, and component repair and overhaul.

We provide major airframe maintenance inspection and overhaul, painting services, line maintenance, airframe modifications, structural repairs, avionics service and installation, exterior and interior refurbishment, and engineering services and support for many types of commercial and military aircraft. We also repair and overhaul landing gears, wheels, and brakes for commercial and military aircraft.

We operate six airframe maintenance facilities and one landing gear overhaul facility. Our landing gear overhaul facility is in Miami, Florida, where we repair and overhaul landing gear, wheels, brakes, and actuators for different types of commercial and military aircraft. Our airframe maintenance facilities are in Indianapolis, Indiana; Oklahoma City, Oklahoma; Duluth, Minnesota; Miami, Florida; and Lake Charles, Louisiana. During fiscal 2015, we also operated a regional aircraft maintenance facility in Hot Springs, Arkansas. On June 24, 2015, we announced our plan to close this facility and transfer its operations to our Oklahoma City facility. We expect to incur approximately \$1.5 million of exit-related costs in fiscal 2016 comprised of severance, relocation, lease termination fees and other exit costs.

Activities in our Aviation Services segment also include the sale and lease of used commercial aircraft. Each sale or lease is negotiated as a separate agreement which includes term, price, representations, warranties, and lease return provisions. During fiscal 2015, we sold our last two remaining wholly-owned aircraft and one aircraft owned with joint venture partners. At May 31, 2015, our remaining portfolio consisted of three aircraft owned through joint ventures.

The majority of our sales are made pursuant to standard commercial purchase orders. U.S. government sales are generally made under standard types of government contracts, including definite contracts which call for the performance of specified services or the delivery of specified products and ID/IQ (i.e., indefinite delivery/indefinite quantity) contracts. Certain inventory supply and management and performance-based logistics program agreements reflect negotiated terms and conditions.

To support activities within the Aviation Services segment, we acquire aviation parts and components from domestic and foreign airlines, independent aviation service companies, aircraft leasing companies,

Table of Contents

and original equipment manufacturers ("OEM"s). We have ongoing arrangements with OEMs that provide us access to parts, repair manuals, and service bulletins in support of parts manufactured by them. Although the terms of each arrangement vary, they typically are made on standard OEM terms as to duration, price, and delivery. From time to time, we purchase engines for disassembly into individual parts and components. These engines may be leased to airlines on a short-term basis prior to disassembly.

Expeditionary Services

The Expeditionary Services segment consists of businesses that provide products and services supporting the movement of equipment and personnel by the DoD, foreign governments and non-governmental organizations. The Expeditionary Services segment accounted for 17%, 28%, and 31% of our sales in fiscal 2015, 2014, and 2013, respectively. Business activities in this segment are primarily conducted through AAR Airlift Group, Inc.; AAR Manufacturing, Inc. and Brown International Corporation (a wholly-owned subsidiary of AAR Manufacturing, Inc.).

We provide expeditionary airlift services to the United States and other government customers. Our expeditionary airlift services provide fixed- and rotary-wing flight operations, transporting personnel and cargo principally in support of the DoD. We operate and maintain a fleet of special mission customized fixed- and rotary-wing aircraft, principally in Afghanistan, Iraq, Northern Africa, and Western Pacific regions. We hold FAR Part 133 and 135 certificates to operate aircraft and a FAR Part 145 certificate to operate a repair station. We are also Commercial Airlift Review Board certified with the DoD.

We design, manufacture, and repair transportation pallets, and a wide variety of containers and shelters used in support of military and humanitarian tactical deployment activities. The containers and shelters are used in numerous mission requirements, including armories, supply and parts storage, refrigeration systems, tactical operation centers, briefing rooms, laundry and kitchen facilities, water treatment, and sleeping quarters. Shelters include both stationary and vehicle-mounted applications.

We also provide engineering, design, and system integration services for specialized command and control systems.

Sales in this segment are made to customers pursuant to standard commercial purchase orders and contracts. U.S. government sales are generally made under standard types of government contracts, including definite contracts which call for the performance of specified services or the delivery of specified products and ID/IQ (i.e., indefinite delivery/indefinite quantity) contracts. The majority of our products and services are procured via definite contracts. We purchase raw materials for this segment, including steel, aluminum, extrusions, and other necessary supplies from several vendors.

Raw Materials

Although we generated 56% of our fiscal 2015 sales from products, our businesses are generally engaged in only limited manufacturing activities and have minimal exposure to fluctuations in both the availability and pricing for raw materials. Where necessary, we have been able to obtain raw materials and other inventory items from numerous sources for each segment at competitive prices, terms, and conditions; we expect to be able to continue to do so.

Terms of Sale

We generally sell our products under standard 30-day payment terms. On occasion, certain customers, principally foreign customers, will negotiate extended payment terms of 60-90 days. Except for customary warranty provisions, customers neither have the right to return products nor do they have the right to extended financing. Our contracts with the DoD and its contractors and other governmental agencies are typically firm agreements to provide products and services at a fixed price or on a time and material basis,

Table of Contents

and have a term of one year or less, frequently subject to extension for one or more additional periods of one year at the option of the government customer.

Customers

We primarily market and sell products and services through our own employees. In certain markets outside of the United States, we rely on foreign sales agents to assist in the sale of our products and services.

The principal customers for our products and services in the Aviation Services segment are domestic and foreign commercial airlines, domestic and foreign freight airlines, regional and commuter airlines, business and general aviation operators, OEMs, aircraft leasing companies, aftermarket aviation support companies, the DoD and its contractors, and foreign military organizations or governments. In the Expeditionary Services segment, our principal customers include the DoD and its contractors and foreign governmental and defense organizations.

Sales of aviation products and services to our commercial airline customers are generally affected by such factors as the number, type and average age of aircraft in service, the levels of aircraft utilization (e.g., frequency of schedules), the number of airline operators, the general economy, and the level of sales of new and used aircraft. Sales to the DoD and other government agencies are subject to a number of factors, including the level of troop deployment worldwide, government funding, competitive bidding, and requirements generated by worldwide geopolitical events.

Sales to Government and Defense Customers

Sales to global government and defense customers (including sales to branches, agencies, and departments of the U.S. government) were \$589.8 million (37.0% of consolidated sales), \$777.5 million (45.4% of consolidated sales) and \$808.0 million (44.7% of consolidated sales) in fiscal 2015, 2014 and 2013, respectively. Sales to branches, agencies, and departments of the U.S. government and their contractors were \$493.1 million (30.9% of consolidated sales), \$661.7 million (38.7% of consolidated sales), and \$733.7 million (40.6% of consolidated sales) in fiscal 2015, 2014, and 2013, respectively. Sales to government and defense customers are reported in each of our reportable segments (See Note 13 of Notes to Consolidated Financial Statements). Since such sales are subject to competitive bidding and government funding, no assurance can be given that such sales will continue at levels previously experienced. The majority of our U.S. government contracts are for products and services supporting the DoD logistics and mobility strategy, as well as for expeditionary airlift services. Thus, our government contracts have changed, and may continue to change, with fluctuations in defense and other governmental agency spending. Our government contracts are also subject to termination by the customer; in the event of such a termination we would be entitled to recover all allowable costs incurred by us through the date of termination.

Government Regulation and Certificates

The Federal Aviation Administration ("FAA") regulates the manufacture, repair, distribution, and operation of all aircraft and aircraft parts operated in the United States. Similar rules and regulatory authorities exist in other countries. The inspection, maintenance and repair procedures for the various types of aircraft and equipment are prescribed by these regulatory authorities and can be performed only by certified repair facilities utilizing certified technicians. The FAA requires that various maintenance routines be performed on aircraft engines, certain engine parts, and airframes at regular intervals based on cycles or flight time. Our businesses which sell defense products and services directly to the U.S. government or through its contractors can be subject to various laws and regulations governing pricing and other factors.

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Table of Contents

We have 13 FAA certificated repair stations in the United States and Europe. Of the 13 certificated FAA repair stations, seven are also European Aviation Safety Agency ("EASA") certificated repair stations. Such certificates, which are ongoing in duration, are required for us to perform authorized maintenance, repair and overhaul services for our customers and are subject to revocation by the government for non-compliance with applicable regulations. Of the 13 FAA certificated repair stations, 12 are in the Aviation Services segment and one is in the Expeditionary Services segment. The seven EASA certificated repair stations are in the Aviation Services segment. We also hold FAR Part 133 and 135 certificates to operate aircraft in our Expeditionary Services segment. We are also Commercial Airlift Review Board certified with the DoD. We believe that we possess all licenses and certifications that are material to the conduct of our business. During fiscal 2015, we operated a regional aircraft maintenance facility in Hot Springs, Arkansas. On June 24, 2015, we announced our plan to close this facility and transfer its operations to our Oklahoma City facility. Once this facility is closed, we will have 12 FAA certificated repair stations.

Competition

Competition in each of our markets is based on quality, ability to provide a broad range of products and services, speed of delivery, and price. Competitors in our Aviation Services segment include OEMs, the service divisions of large commercial airlines, and other independent suppliers of parts, repair, and overhaul services to the commercial and defense markets. Our Expeditionary Services segment competes with domestic and foreign contracting companies and a number of divisions of large corporations and other large and small companies. Although certain of our competitors have substantially greater financial and other resources than we do, we believe that we have maintained a satisfactory competitive position through our responsiveness to customer needs, our attention to quality, and our unique combination of market expertise and technical and financial capabilities.

Backlog

Backlog represents the amount of revenue that we expect to derive from unshipped orders or signed contracts. At May 31, 2015, backlog was approximately \$950.6 million compared to \$811.7 million at May 31, 2014. Approximately \$450.7 million of our May 31, 2015 backlog is expected to be filled within the next 12 months.

Employees

At May 31, 2015, we employed approximately 4,850 employees worldwide, of which approximately 150 employees are subject to a collective bargaining agreement. We also retain approximately 900 contract workers, the majority of whom are located at our airframe maintenance facilities.

Available Information

For additional information concerning our business segments, see Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Business Segment Information" in Note 13 of Notes to Consolidated Financial Statements under Item 8, "Financial Statements and Supplementary Data."

Our internet address is www.aarcorp.com. We make available free of charge through our web site our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after we electronically file such material with, or furnish such material to, the Securities and Exchange Commission. Information contained on our web site is not a part of this report.

Table of Contents

ITEM 1A. RISK FACTORS

The following is a description of the principal risks inherent in our business.

We are affected by factors that adversely impact the commercial aviation industry.

As a provider of products and services to the commercial aviation industry, we are greatly affected by overall economic conditions of that industry. The commercial aviation industry is historically cyclical and has been negatively affected in the past by geopolitical events, high fuel and oil prices, lack of capital, and weak economic conditions. In addition, as a result of these and other events, from time to time certain of our customers have filed for bankruptcy protection or ceased operation. The impact of instability in the global financial markets may lead airlines to reduce domestic or international capacity. In addition, certain of our airline customers have in the past been impacted by tight credit markets, which limited their ability to buy parts, services, engines, and aircraft.

A reduction in the operating fleet of aircraft both in the U.S. and abroad will result in reduced demand for parts support and maintenance activities for the type of aircraft affected. Further, tight credit conditions negatively impact the amount of liquidity available to buy parts, services, engines, and aircraft. A deteriorating airline environment may also result in additional airline bankruptcies, and in such circumstances we may not be able to fully collect outstanding accounts receivable. Reduced demand from customers caused by weak economic conditions, including tight credit conditions and customer bankruptcies, may adversely impact our financial condition or results of operations.

Our business, financial condition, results of operations, and growth rates may be adversely affected by these and other events that impact the aviation industry, including the following:

deterioration in the financial condition of our existing and potential customers;

reductions in the need for, or the deferral of, aircraft maintenance and repair services and spare parts support;

retirement of older generation aircraft, resulting in lower prices for spare parts and services for those aircraft;

reductions in demand for used aircraft and engines;

increased in-house maintenance by airlines;

lack of parts in the marketplace;

future terrorist attacks and the ongoing war on terrorism;

future outbreaks of infectious diseases; and

acts of God.

Our U.S. government contracts may not continue at present sales levels, which may have a material adverse effect on our financial condition and results of operations.

Our sales to branches, agencies and departments of the U.S. government and their contractors were \$493.1 million (30.9% of consolidated sales) in fiscal 2015 (See Note 13 of Notes to Consolidated Financial Statements). The majority of our U.S. government contracts is for products and services supporting DoD logistics and mobility strategy, as well as for expeditionary airlift services and is, therefore, subject to changes in defense and other governmental agency funding and spending. Our contracts with the U.S. government, including the DoD and its contractors,

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are typically agreements to provide products and services at a fixed price and have a term of one year or less, frequently subject to extension for one or more additional periods of one year at the option of the government customer. Sales to agencies of the U.S. government and their contractors are subject to a number of factors, including the level of troop

Table of Contents

deployment worldwide, competitive bidding, U.S. government funding, requirements generated by world events, and budgetary constraints.

Defense funding continues to face pressure due to U.S. budget deficit challenges. Congress enacted the Budget Control Act of 2011 ("Budget Act"), which reduced defense spending by a minimum of \$487 billion over a ten-year period that began in the government's fiscal year 2012. The Budget Act also provided that the defense budget would face "sequestration" cuts of up to an additional \$500 billion during that same period to the extent that discretionary spending limits are exceeded. The impact of sequestration cuts was reduced with respect to the government's fiscal years 2014 and 2015 following the enactment of The Bipartisan Budget Act in December 2013. However, significant uncertainty remains with respect to overall levels of defense spending and it is likely that U.S. government discretionary spending levels will continue to be constrained, including risk of future sequestration cuts.

Future congressional appropriation and authorization of defense spending and the application of sequestration remain marked by significant debate and an uncertain schedule. The federal debt limit continues to be actively debated as plans for long-term national fiscal policy are discussed. The outcome of these debates could have a significant impact on defense spending broadly and programs we support in particular.

If the existing federal debt limit is not raised, we may be required to continue to perform for some period of time on certain of our U.S. government contracts even if the U.S. government is unable to make timely payments. Future budget cuts, including cuts mandated by sequestration, or future procurement decisions could result in reductions, cancellations, and/or delays of existing contracts or programs which could adversely affect our results of operations and financial condition.

We face risks of cost overruns and losses on fixed-price contracts.

We sell certain of our products and services to our commercial, government, and defense customers under firm contracts providing for fixed unit prices, regardless of costs incurred by us. The cost of producing products or providing services may be adversely affected by increases in the cost of labor, materials, fuel, overhead, and other unknown variants, including manufacturing and other operational inefficiencies and differences between assumptions used by us to price a contract and actual results. Increased costs may result in cost overruns and losses on such contracts, which could adversely affect our results of operations and financial condition.

Success at our airframe maintenance facilities is dependent upon continued outsourcing by the airlines.

We currently perform airframe maintenance, repair and overhaul activities at six leased facilities one of which is in the process of being closed. Revenues at these facilities fluctuate based on demand for maintenance which, in turn, is driven by the number of aircraft operating and the extent of outsourcing of maintenance activities by airlines. In addition, certain airlines operate certain new fleet types and/or newer generation aircraft and we may not have contractual arrangements to service these aircraft nor technicians trained and certified to perform the required airframe maintenance, repair and overhaul activities. If either the number of aircraft operating or the level of outsourcing of maintenance activities declines, we may not be able to execute our operational and financial plans at our maintenance, repair and overhaul facilities, which could adversely affect our results of operations and financial condition.

We operate in highly competitive markets, and competitive pressures may adversely affect us.

The markets for our products and services to our commercial, government, and defense customers are highly competitive, and we face competition from a number of sources, both domestic and international. Our competitors include aircraft manufacturers, aircraft component and parts manufacturers, airline and aircraft service companies, other companies providing maintenance, repair and overhaul services, other aircraft spare parts distributors and redistributors, and other expeditionary airlift service providers. Some

Table of Contents

of our competitors have substantially greater financial and other resources than we have and others may price their products and services below our selling prices. We believe that our ability to compete depends on superior customer service and support, on-time delivery, sufficient inventory availability, competitive pricing and effective quality assurance programs.

Our government customers, including the DoD, may turn to commercial contractors, rather than traditional defense contractors, for certain work, or may utilize small business contractors or determine to source work internally rather than use us. We are also impacted by bid protests from unsuccessful bidders on new program awards. Bid protests could result in significant expense for us, contract modifications, or the award decision being overturned and loss of the contract award. Even where a bid protest does not result in the loss of an award, the resolution can extend the time until the contract activity can begin, and delay earnings. These competitive pressures, with potential impacts on both our commercial and government business, could adversely affect our results of operations and financial condition.

We are subject to significant government regulation and may need to incur significant expenses to comply with new or more stringent governmental regulation.

The aviation industry is highly regulated by the FAA in the United States and equivalent regulatory agencies in other countries. Before we sell any of our products that are to be installed in an aircraft, such as engines, engine parts and components, and airframe and accessory parts and components, they must meet certain standards of airworthiness established by the FAA or the equivalent regulatory agencies in certain other countries. We operate repair stations that are licensed by the FAA and the equivalent regulatory agencies in certain other countries, and hold certificates to operate aircraft. Specific regulations vary from country to country, although regulatory requirements in other countries are generally satisfied by compliance with FAA requirements. New and more stringent governmental regulations may be adopted in the future that, if enacted, may have an adverse impact on us.

If any of our material licenses, certificates, authorizations, or approvals were revoked or suspended by the FAA or equivalent regulatory agencies in other countries, our results of operations and financial condition may be adversely affected.

If we fail to comply with government procurement laws and regulations, we could lose business and be liable for various penalties or sanctions.

We must comply with laws and regulations relating to the formation, administration, and performance of U.S. government contracts. These laws and regulations include the Federal Acquisition Regulations, Defense Federal Acquisition Regulations, the Truth in Negotiations Act, Cost Accounting Standards, and laws, regulations, and orders restricting the use and dissemination of classified information under the U.S. export control laws and the export of certain products and technical information. Certain government contracts provide audit rights by government agencies, including with respect to performance, costs, internal controls and compliance with applicable laws and regulations. In complying with these laws and regulations, we may incur significant costs, and non-compliance may result in the imposition of fines and penalties, including contractual damages. If we fail to comply with these laws and regulations or if a government audit, review, or investigation uncovers improper or illegal activities, we may be subject to civil penalties, criminal penalties, or administrative sanctions, including debarment from contracting with the U.S. government. Our reputation could suffer harm if allegations of impropriety were made against us, which could adversely affect our operating performance and may result in additional expenses and possible loss of revenue.

Table of Contents

A significant portion of our expeditionary airlift revenue is derived from providing expeditionary airlift services in Afghanistan.

Our expeditionary airlift business derives a significant portion of its revenue from providing expeditionary airlift services in Afghanistan for the DoD. The U.S. has been reducing military activities in Afghanistan and began calendar year 2015 with approximately 10,000 military personnel in Afghanistan. The U.S. government previously announced plans to reduce the number of troops in Afghanistan by approximately half before the end of calendar year 2016. Recent indications are that the reduction in troops may be slower than previously communicated. Our expeditionary airlift services revenue will likely experience further declines as troop reductions occur in Afghanistan.

We are bidding on expeditionary airlift contracts in other regions supporting both DoD and non-DoD customers, although there can be no assurance we will be awarded any of these contracts. Although we expect ongoing demand for expeditionary airlift services in Afghanistan and other regions from the DoD and other governmental departments, we are exposed to the risk that our expeditionary airlift revenues may further decline if contracts are not renewed, renewed only in part, or are terminated, which could adversely affect our results of operations and financial condition. If we are unable to successfully redeploy aircraft not actively supporting current customers at favorable rates or sell them on favorable terms, it could have a material adverse effect on our business, results of operations and financial condition.

U.S. government contractors that provide support services in theaters of conflict such as Afghanistan have come under increasing scrutiny by agency inspectors general, government auditors and congressional committees. Investigations pursued by any or all of these groups may result in adverse publicity for us and reputational harm, regardless of the underlying merit of the allegations being investigated.

We are exposed to risks associated with operating internationally.

We conduct our business in certain foreign countries, some of which are politically unstable or subject to military or civil conflicts. Consequently, we are subject to a variety of risks that are specific to international operations, including the following:

military conflicts, civil strife, and political risks;

export regulations that could erode profit margins or restrict exports;

compliance with the U.S. Foreign Corrupt Practices Act, UK Anti-bribery Act, and other anti-bribery laws;

the burden and cost of compliance with foreign laws, treaties, and technical standards and changes in those regulations;

contract award and funding delays;

potential restrictions on transfers of funds;

import and export duties and value added taxes;

foreign exchange risk;

transportation delays and interruptions; and

uncertainties arising from foreign local business practices and cultural considerations.

While we have adopted and will continue to adopt measures to reduce the potential impact of losses resulting from the risks of doing business internationally, we cannot ensure that such measures will be adequate or that the regions in which we operate will continue to be stable

enough to allow us to operate profitably or at all.

Table of Contents

Acquisitions expose us to risks, including the risk that we may be unable to effectively integrate acquired businesses.

We explore and have discussions with third parties regarding acquisitions on a regular basis. Acquisitions involve risks, including difficulties in integrating the operations and personnel, the effects of amortization of any acquired intangible assets and the potential impairment of goodwill, and the potential loss of key employees of the acquired business. In addition, acquisitions often require substantial management resources and have the potential to divert our attention from our existing business. For any businesses we may acquire in the future, we may not be able to execute our operational, financial, or integration plans for the acquired businesses, which could adversely affect our results of operations and financial condition.

Market values for our aviation products fluctuate, and we may be unable to re-lease or sell aircraft and engines when their current lease expires.

We use a number of assumptions when determining the recoverability of inventories, aircraft, and engines, which are on lease or available for lease. These assumptions include historical sales trends, current and expected usage trends, replacement values, current and expected lease rates, residual values, future demand, and future cash flows. Reductions in demand for our inventories or declining market values, as well as differences between actual results and the assumptions utilized by us when determining the recoverability of our inventories, aircraft, and engines, could result in impairment charges in future periods, which would adversely affect our results of operations and financial condition.

We lease aircraft and engines to our customers on an operating lease basis. Our ability to re-lease or sell these assets on acceptable terms when the lease expires is subject to a number of factors which drive industry capacity, including new aircraft deliveries, availability of used aircraft and engines in the marketplace, competition, financial condition of our customers, overall health of the airline industry, and general economic conditions. Our inability to re-lease or sell aircraft and engines could adversely affect our results of operations and financial condition.

We may need to reduce the carrying value of our assets.

We own and distribute a significant amount of aircraft, aircraft parts and components, and manufacturing facilities and related equipment. The removal of aircraft from service or recurring losses in certain operations could require us to evaluate the recoverability of the carrying value of those assets and record an impairment charge through earnings to reduce the carrying value. We recognized impairment charges and other losses of \$71.4 million in fiscal 2015 related to our actions to address underperforming product lines and inventories. In addition, if aircraft or engines for which we offer replacement parts or supply repair and overhaul services are retired and there are fewer aircraft that require these parts or services, our revenues may decline.

We have recorded goodwill and other intangible assets related to acquisitions. If we are unable to achieve the projected levels of operating results, it may be necessary to record an impairment charge to reduce the carrying value of goodwill and related intangible assets. Similarly, if we were to lose a key customer or one of our airframe maintenance or landing gear facilities were to lose its authority to operate, we might be required to record an impairment charge.

We are dependent upon continued availability of financing to manage our business and to execute our business strategy, and additional financing may not be available on terms acceptable to us.

Our ability to manage our business and to execute our business strategy is dependent, in part, on the continued availability of debt and equity capital. Access to the debt and equity capital markets may be limited by various factors, including the condition of overall credit markets, general economic factors, state of the aviation industry, our financial performance, and credit ratings. Debt and equity capital may not

Table of Contents

continue to be available to us on favorable terms, or at all. Our inability to obtain financing on favorable terms could adversely affect our results of operations and financial condition.

Our existing debt includes restrictive and financial covenants.

Certain loan and debt agreements require us to comply with various restrictive covenants and some contain financial covenants that require us to comply with specified financial ratios and tests. Our failure to meet these covenants could result in default under these loan and debt agreements and may result in a cross-default under other debt agreements. In the event of a default and our inability to obtain a waiver of the default, all amounts outstanding under our debt agreements could be declared immediately due and payable. Our failure to comply with these covenants could adversely affect our results of operations and financial condition.

Our industry is susceptible to product and other liability claims, and claims not adequately covered by insurance may adversely affect our financial condition.

Our business exposes us to possible claims for property damage and bodily injury or death which may result if an engine, engine part or component, airframe part or accessory, or any other aviation product which we have sold, manufactured, or repaired fails, or if an aircraft we operated, serviced, or in which our products are installed, crashes we carry substantial liability insurance in amounts that we believe are adequate for our risk exposure and commensurate with industry norms. However, claims may arise in the future, and our insurance coverage may not be adequate to protect us in all circumstances. Additionally, we might not be able to maintain adequate insurance coverage in the future at an acceptable cost. Any liability claim not covered by adequate insurance could adversely affect our results of operations and financial condition.

Our business could be negatively affected by cyber or other security threats or other disruptions.

Our businesses depend heavily on information technology and computerized systems to communicate and operate effectively. The Company's systems and technologies, or those of third parties on which we rely, could fail or become unreliable due to equipment failures, software viruses, cyber threats, terrorist acts, natural disasters, power failures or other causes. These threats arise in some cases as a result of our role as a defense contractor.

Cyber security threats are evolving and include, but are not limited to, malicious software, attempts to gain unauthorized access to our sensitive information, including our customers, suppliers, subcontractors, and joint venture partners, and other electronic security breaches that could lead to disruptions in mission critical systems, unauthorized release of confidential or otherwise protected information, and corruption of data.

Although we utilize various procedures and controls to monitor and mitigate these threats, there can be no assurance that these procedures and controls will be sufficient to prevent security threats from materializing. If any of these events were to materialize, the costs related to cyber or other security threats or disruptions may not be fully insured or indemnified and could have a material adverse effect on our reputation, operating results, and financial condition.

We must comply with extensive environmental requirements, and any exposure to environmental liabilities may adversely affect us.

Federal, state, and local requirements relating to the discharge and emission of substances into the environment, the disposal of hazardous wastes, the remediation and abatement of contaminants, and other activities affecting the environment have had and may continue to have an impact on our operations. Management cannot assess the possible effect of compliance with future environmental requirements or of future environmental claims for which we may not have adequate indemnification or insurance coverage. If

Table of Contents

we were required to pay the expenses related to any future environmental claims for which neither indemnification nor insurance coverage were available, these expenses could have an adverse impact on our results of operations and financial condition.

Future environmental regulatory developments in the United States and abroad concerning environmental issues, such as climate change, could adversely affect our operations and increase operating costs and, through their impact on our customers, reduce demand for our products and services. Actions may be taken in the future by the U.S. government, state governments within the United States, foreign governments, the International Civil Aviation Organization, or by signatory countries through a new global climate change treaty to regulate the emission of greenhouse gases by the aviation industry. The precise nature of any such requirements and their applicability to us and our customers are difficult to predict, but the impact to us and the aviation industry would likely be adverse and could be significant, including the potential for increased fuel costs, carbon taxes or fees, or a requirement to purchase carbon credits.

We may need to make significant capital expenditures to keep pace with technological developments in our industry.

The industries in which we participate are constantly undergoing development and change, and it is likely that new products, equipment, and methods of repair and overhaul services will be introduced in the future. We may need to make significant expenditures to purchase new equipment and to train our employees to keep pace with any new technological developments. These expenditures could adversely affect our results of operations and financial condition.

Our operations would be adversely affected by a shortage of skilled personnel or work stoppages.

We are dependent on an educated and highly skilled workforce, because of the complex nature of many of our products and services. Furthermore, we have a collective bargaining agreement covering approximately 150 employees. Our ability to operate successfully and meet our customers' demands could be jeopardized if we are unable to attract and retain a sufficient number of skilled personnel, including qualified licensed mechanics, to conduct our business, or if we experience a significant or prolonged work stoppage. These and similar events may adversely affect our results of operations and financial condition.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not Applicable.

ITEM 2. PROPERTIES

In the Aviation Services segment, we conduct inventory management and distribution activities from our headquarters in Wood Dale, Illinois, which we own subject to a mortgage. In addition to warehouse space, this facility includes executive, sales and administrative offices. Our principal maintenance, repair, overhaul, and engineering activities for this segment are conducted at facilities leased by us in Indianapolis, Indiana; Oklahoma City, Oklahoma; Miami, Florida; Duluth, Minnesota; and Lake Charles, Louisiana. During fiscal 2015, we also operated a leased regional aircraft maintenance facility in Hot Springs, Arkansas. On June 24, 2015, we announced our plan to close this facility and transfer its operations to our Oklahoma City facility.

We also lease facilities in Garden City, New York; Jacksonville, Florida; and London, England, and own a building near Schiphol International Airport in the Netherlands to support activities in the Aviation Services segment.

Our principal activities in the Expeditionary Services segment are conducted at facilities we lease in Melbourne, Florida and own in Cadillac, Michigan and Goldsboro, North Carolina.

Table of Contents

We also operate sales offices which support all our activities and are leased in London, England; Paris, France; Rio de Janeiro, Brazil; Shanghai, China; Singapore, Republic of Singapore; and Abu Dhabi, UAE.

We believe that our owned and leased facilities are suitable and adequate for our operational requirements.

ITEM 3. LEGAL PROCEEDINGS

We are not a party to any material, pending legal proceeding (including any governmental or environmental proceedings) other than routine litigation incidental to our business.

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable.

Supplemental Item:

EXECUTIVE OFFICERS OF THE REGISTRANT

Information concerning each of our executive officers is set forth below:

Name	Age	Present Position with the Company
David P. Storch	62	Chairman and Chief Executive Officer, Director
Timothy J. Romenesko	58	President and Chief Operating Officer Expeditionary Services, Director
John C. Fortson	48	Vice President, Chief Financial Officer and Treasurer
Robert J. Regan	57	Vice President, General Counsel and Secretary
Michael J. Sharp	53	Vice President, Controller and Chief Accounting Officer
John Holmes	38	Chief Operating Officer Aviation Services

Mr. Storch is Chairman of the Board and Chief Executive Officer of AAR, having served in that capacity since October 2005. From 1996 to 2005, Mr. Storch served as President and Chief Executive Officer and from 1989 to 1996 he served as Chief Operating Officer. Prior to that, Mr. Storch served as a Vice President of the Company from 1988 to 1989. Mr. Storch joined the Company in 1979 and also served as president of a major subsidiary from 1984 to 1988. Mr. Storch has been a director of the Company since 1989.

Mr. Romenesko is President and Chief Operating Officer Expeditionary Services, having served in that capacity since June 2015. Previously, he served as President and Chief Operating Officer of the Company from 2007, and Vice President and Chief Financial Officer from 1994 to 2007. Mr. Romenesko also served as Controller from 1991 to 1995, and in various other positions since joining AAR in 1981. Mr. Romenesko has been a director of the Company since 2007.

Mr. Fortson joined the Company as Vice President, Finance in May 2013, and became Vice President, Chief Financial Officer and Treasurer on July 26, 2013. Prior to joining the Company, he was a Managing Director of Investment Banking at Bank of America Merrill Lynch since 2007.

Mr. Regan is Vice President, General Counsel and Secretary, having served in that capacity since June 2009. From 2008 to June 2009, Mr. Regan served as Vice President and General Counsel and, prior to that, Associate General Counsel since joining AAR in February 2008. Prior to joining AAR, he was a partner at the law firm of Schiff Hardin LLP since 1989.

Mr. Sharp is Vice President, Controller and Chief Accounting Officer, having served in those capacities since July 1996 and April 1999, respectively. Mr. Sharp was Vice President, Chief Financial Officer and Treasurer from October 2012 to July 26, 2013. Prior to joining the Company, he was with Kraft Foods from 1994 to 1996, and with KPMG LLP from 1984 to 1994.

Table of Contents

Mr. Holmes is Chief Operating Officer Aviation Services, having served in that capacity since February 2015. Mr. Holmes previously served as Group Vice President, Aviation Services Inventory Management and Distribution since 2012, General Manager and Division President of our Allen Asset Management business since 2003, and in various other positions since joining the Company in September 2001.

Each executive officer is elected annually by the Board of Directors at the first meeting of the Board held after the annual meeting of stockholders. Executive officers continue to hold office until their successors are duly elected or until their death, resignation, termination or reassignment.

Table of Contents**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our common stock is traded on the New York Stock Exchange and the Chicago Stock Exchange under the symbol "AIR." On July 1, 2015, there were approximately 1,061 holders of common stock, including participants in security position listings.

The following table shows the range of prices for our common stock and the amount of dividends declared per share during each quarter of our last two fiscal years:

	Fiscal 2015				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Full Year
Market price					
High	\$ 28.33	\$ 29.05	\$ 31.93	\$ 34.24	\$ 34.24
Low	23.74	22.37	25.04	29.18	22.37
Dividends declared	0.075	0.075	0.075	0.075	0.30

	Fiscal 2014				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Full Year
Market price					
High	\$ 25.84	\$ 31.30	\$ 30.56	\$ 31.05	\$ 31.30
Low	20.06	25.51	25.91	24.22	20.06
Dividends declared	0.075	0.075	0.075	0.075	0.30

Stockholder Return Performance Graph

The following graph compares the total return on a cumulative basis of \$100 invested, and reinvestment of dividends in our common stock on May 31, 2010 to the Standard and Poor's ("S&P") 500 Index and the Proxy Peer Groups.

Comparison of Cumulative Five Year Total Return

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Table of Contents

The S&P 500 Index is comprised of domestic industry leaders in four major sectors: Industrial, Financial, Utility, and Transportation, and serves as a broad indicator of the performance of the U.S. equity market. The Proxy Peer Group companies are listed as follows:

Aerojet Rocketdyne Holdings, Inc. ¹ Applied Industrial Technologies, Inc. B/E Aerospace, Inc. Crane Co. Cubic Corporation Curtiss-Wright Corporation Esterline Technologies Corporation Hexcel Corporation Kaman Corporation Kratos Defense & Security	Moog Inc. Orbital ATK, Inc. ² Rockwell Collins, Inc. Spirit AeroSystems Holdings Teledyne Technologies Incorporated TransDigm Group Inc. Triumph Group, Inc. Woodward, Inc. ¹ Wesco International, Inc. ¹
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¹ These companies are new peer group companies added during fiscal 2015.

² Orbital ATK, Inc. is the successor entity to the merger of Alliant Techsystems, Inc. (included in our Proxy Peer Group in fiscal 2014) and Orbital Sciences Corporation.

Kennametal, Inc. and MSC Industrial Direct Co., Inc. are no longer included in our Proxy Peer Group. The Company annually revisits the composition of the peer group to ensure that the Company's performance is measured against those of comparably-sized and situated companies. The mix of the Company's commercial and defense businesses presents a challenge in constructing a peer group, given that many defense contractors have substantially greater resources than the Company.

Issuer Purchases of Equity Securities

The following table provides information about purchases we made during the quarter ended May 31, 2015 of equity securities that are registered by us pursuant to Section 12 of the Exchange Act:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs ¹	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
3/1/2015 - 3/31/2015		\$		
4/1/2015 - 4/30/2015	496,660	30.40	496,660	
5/1/2015 - 5/31/2015	4,185,960	31.90	4,185,960	
Total	4,682,620	\$ 31.74	4,682,620	\$ 101,336,732

¹ On March 16, 2015, we announced a new Board of Directors authorization to purchase up to \$250 million of our common stock with no expiration date. The shares in May were purchased pursuant to a tender offer completed on May 29, 2015.

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Table of Contents

ITEM 6. SELECTED FINANCIAL DATA
(In millions, except per share amounts)

	For the Year Ended May 31,				
	2015	2014	2013	2012	2011
<u>RESULTS OF OPERATIONS</u>¹					
Sales	\$ 1,594.3	\$ 1,709.1	\$ 1,807.9	\$ 1,865.7	\$ 1,723.9
Gross profit ²	159.3	288.9	259.5	287.7	295.5
Operating income (loss) ²	(11.9)	125.6	102.2	118.4	129.4
(Loss) gain on extinguishment of debt ³	(44.9)		(0.3)	(0.7)	0.1
Interest expense	26.5	28.3	29.1	30.2	27.6
Income (Loss) from continuing operations	(54.5)	67.2	48.8	64.9	69.1
Income from discontinued operations ⁴	64.7	5.7	6.2	2.8	0.7
Net income attributable to AAR	10.2	72.9	55.0	67.7	69.8
Share data:					
Earnings per share basic:					
Earnings (Loss) from continuing operations	\$ (1.40)	\$ 1.70	\$ 1.23	\$ 1.61	\$ 1.74
Earnings from discontinued operations	1.66	0.15	0.15	0.07	0.02
Earnings per share basic	\$ 0.26	\$ 1.85	\$ 1.38	\$ 1.68	\$ 1.76
Earnings per share diluted:					
Earnings (Loss) from continuing operations	\$ (1.40)	\$ 1.68	\$ 1.23	\$ 1.58	\$ 1.71
Earnings from discontinued operations	1.64	0.15	0.15	0.07	0.02
Earnings per share diluted	\$ 0.24	\$ 1.83	\$ 1.38	\$ 1.65	\$ 1.73
Cash dividends declared per share	\$ 0.30	\$ 0.30	\$ 0.30	\$ 0.30	\$ 0.08
Weighted average common shares outstanding basic	39.1	38.6	38.3	38.8	38.4
Weighted average common shares outstanding diluted	39.4	39.1	40.6	43.1	43.6

	May 31,				
	2015	2014	2013	2012	2011
<u>FINANCIAL POSITION</u>					
Total cash and cash equivalents	\$ 54.7	\$ 89.2	\$ 75.3	\$ 67.7	\$ 57.4
Working capital	542.1	709.3	644.7	590.1	498.0
Total assets	1,515.0	2,194.0	2,136.9	2,195.7	1,703.7
Total debt ³	154.0	634.0	708.6	792.2	425.3
Equity ⁵	845.1	1,000.7	919.5	866.0	835.3

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Number of shares outstanding at end of year ⁴	35.4	39.6	39.4	40.3	39.8
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Book value per share of common stock	\$ 23.87	\$ 25.27	\$ 23.34	\$ 21.50	\$ 21.00
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Notes:

¹ Telair Cargo Group and Precision Systems Manufacturing have been reported as discontinued operations in the results of operations for all periods presented.

Table of Contents

2

In fiscal 2015, we recognized \$71.4 million in impairment charges and other losses related to product lines and inventories identified as underperforming or not part of our strategy going forward. These actions included aircraft in our aircraft lease portfolio, inventory in our supply chain and MRO operations, and certain aircraft and inventory in our expeditionary airlift business.

In fiscal 2013, we recorded a \$29.8 million charge due to lower revenue and profit expectations on a contract supporting the KC10 aircraft as a result of lower than expected flight hours of the KC10 aircraft and changes to our anticipated recovery of costs in excess of amounts billed within this contract.

3

In fiscal 2015, we redeemed our \$325 million 7.25% Senior Notes due 2022 for \$370.6 million. We recognized a loss on extinguishment of debt of \$44.9 million comprised of a make-whole premium of \$45.6 million and unamortized deferred financing costs of \$6.2 million, partially offset by an unamortized net premium of \$6.9 million.

4

In fiscal 2015, we sold our Telair Cargo Group for \$725 million resulting in a \$198.6 million pre-tax gain. In addition, we announced our intention to sell our PSM business and recognized impairment charges of \$57.5 million to reduce the carrying value of PSM business's net assets to their expected value at the time of sale.

5

On May 29, 2015, we repurchased 4,185,960 shares of our common stock at a price of \$31.90 per share pursuant to a tender offer utilizing \$133.5 million cash on hand. Fees and expenses of \$1.2 million were incurred related to the tender offer and were recorded in treasury stock.

Table of Contents

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Dollars in millions)

Forward-Looking Statements

Management's Discussion and Analysis of Financial Condition and Results of Operations contain certain statements relating to future results, which are forward-looking statements as that term is defined in the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on the beliefs of 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 materially from historical results or those anticipated, depending on a variety of factors, including those factors discussed under Item 1A, "Risk Factors." 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.

General Overview

Upon completing our annual strategic review process and assessing our markets, we entered fiscal 2015 with a mission to narrow our focus, excel as an independent services provider to the global commercial aviation and government and defense markets, strengthen our balance sheet, and improve shareholder return. The comprehensive plan included exploring selling certain manufacturing businesses and as the year progressed included a review of our underperforming product lines and inventories in our services businesses to determine which product areas to focus on going forward. The first phase of this transformation included the sale of the Telair Cargo Group for \$725 million in the fourth quarter of fiscal 2015 which resulted in a pre-tax gain (net of transaction expenses and fees) of \$198.6 million. The gain excludes \$35 million of contingent consideration which could be realized prior to December 31, 2015. Our plans further called for us to sell our Precision Systems Manufacturing ("PSM") business, comprised of our metal and composite machined and fabricated parts manufacturing operations. During fiscal 2015, we recognized total impairment charges of \$57.5 million to reduce the carrying value of PSM's net assets to their expected value at time of sale.

The product lines and inventories identified as underperforming or not part of our strategy going forward in our services businesses included certain aircraft in our aircraft lease portfolio, inventory and rotatable assets in our supply chain and maintenance, repair and overhaul ("MRO") operations, and certain aircraft and inventory in our expeditionary airlift business. We recognized \$71.4 million in impairment charges and other losses in fiscal 2015 from these actions while at the same time generating approximately \$57.1 million of cash.

By executing this plan, we strengthened our balance sheet and returned capital to shareholders. Using the proceeds from the sale of the Telair Cargo Group and other assets, we reduced our total debt from \$634.0 million at May 31, 2014 to \$154.0 million at May 31, 2015. Taking into consideration cash on hand, our net debt position at May 31, 2015 is \$99.3 million. In addition, we acquired 4,682,620 of our common shares during fiscal 2015 for an aggregate cost of \$151.5 million, and paid \$12.5 million in dividends.

As we enter fiscal 2016, we find ourselves in a strong financial position to build out our strategy as a best in class aviation and expeditionary services company. Our cash on hand plus unused capacity on our Credit Agreement is \$490 million at May 31, 2015. We expect to invest opportunistically in expanding our comprehensive suite of services to the global commercial aviation and government and defense markets.

Table of Contents

Changes in Segment Presentation

We began reporting our Telair Cargo Group and PSM businesses as discontinued operations in the third quarter of fiscal 2015. The decision to sell these two businesses was an important strategic step to position us as a pure-play, industry-leading global aviation and expeditionary services company and will allow us to focus our resources where we see the best opportunities.

Prior to the decision to sell these two businesses, we reported our activities in the following two business segments: Aviation Services comprised of our supply chain, maintenance, repair and overhaul ("MRO") and airlift activities and *Technology Products* comprised of our Telair Cargo Group, Precision Systems Manufacturing, and mobility businesses.

As a result of the decision to divest the Telair Cargo Group and PSM, we have revised our reportable segments to align to our new organizational structure. We now report our results in two new segments: *Aviation Services* comprised of supply chain and MRO activities and *Expeditionary Services* comprised of airlift and mobility activities. This new presentation reflects the way our chief operating decision making officer (Chief Executive Officer) now evaluates performance and our internal organizational and management structure.

The Aviation Services segment consists of businesses that provide spares and maintenance support for aircraft operated by our commercial and government/defense customers. 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, landing gear and components. We also sell and lease used commercial aircraft (exclusively through joint ventures following the sale of our last two wholly-owned aircraft in the fourth quarter of fiscal 2015). Cost of sales consists principally of the cost of product, direct labor, and overhead.

The Expeditionary Services segment consists of businesses that provide products and services supporting the movement of equipment and personnel by the U.S. DoD, foreign governments and non-governmental organizations. Sales in the Expeditionary Services segment are derived from the delivery of airlift services to mostly government and defense customers and the design and manufacture of pallets, shelters, and containers used to support the U.S. military's requirements for a mobile and agile force. We also provide system integration services for specialized command and control systems. Cost of sales consists principally of aircraft maintenance costs, depreciation, the cost of material to manufacture products, direct labor and overhead.

Segment results have been reclassified to reflect our new segment presentation for all periods presented. The Telair Cargo Group and PSM businesses have been reported as discontinued operations for all periods presented.

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.

Business Trends and Outlook for Fiscal 2016

Consolidated sales for fiscal 2015 decreased \$114.8 million or 6.7% compared to the prior year primarily due to a decrease of \$187.7 million or 24.1% in sales to government and defense customers. The reduction in sales to government and defense customers was primarily due to a \$206.6 million decline in sales within our Expeditionary Services segment to government and defense customers. The DoD's

Table of Contents

reduced role in Afghanistan as a result of the troop drawdown has had a significant impact on our expeditionary airlift services operations in Afghanistan. At the beginning of fiscal 2014, we had 40 aircraft contract positions which reduced to 20 positions by the end of fiscal 2014. We were largely able to offset additional contract terminations in Afghanistan during fiscal 2015 with new contract positions in Africa and ended fiscal 2015 at 19 aircraft positions.

We believe that the pipeline of opportunities in the airlift services market will enable us to return our idled aircraft to revenue service. In March 2015, we were awarded a contract from the United Nations for passenger and cargo air charter services in support of the MONUSCO operation, the United Nations Organization Stabilization Mission in the Democratic Republic of Congo. We also expect to have aircraft in revenue service in Iraq in early fiscal 2016 which represents a new geography for our expeditionary airlift services business.

During fiscal 2015, sales to commercial customers increased \$72.9 million or 7.8% compared to the prior year driven primarily by higher supply chain volumes principally from new contract wins announced in the second half of fiscal 2014. This increase was partially offset by a significant engineering services program that ended in the second quarter of fiscal 2014 which represented \$14.6 million of sales in the prior period. We also experienced a decrease in sales of \$13.7 million related to lower volumes in our maintenance, repair and overhaul services businesses.

For fiscal 2016, we expect to see continued growth in our aviation services platform given their strong positions in the growing global aviation market which should benefit commercial sales in our Aviation Services segment. We believe there continues to be a favorable trend by both commercial and government and defense customers for comprehensive supply chain and maintenance programs, as these customers continue to seek ways to reduce their operating cost structure. As part of our three phased transformation in fiscal 2015, we have reorganized the sales and business development areas and other functions within our Aviation Services segment to capitalize on our comprehensive supply chain and maintenance solutions. While defense budgets are expected to remain under pressure due to budgetary constraints and the current geopolitical environment, we see ongoing demand for our low cost solutions, products and services.

Results of Operations Fiscal 2015 Compared with Fiscal 2014

Sales and gross profit for our two business segments for the two years ended May 31, 2015 and 2014 were as follows:

	For the Year Ended May 31,		
	2015	2014	% Change
Sales:			
Aviation Services			
Commercial	\$ 985.7	\$ 919.9	7.2%
Defense	330.4	311.3	6.1%
	\$ 1,316.1	\$ 1,231.2	6.9%
Expeditionary Services			
Commercial	\$ 18.8	\$ 11.7	60.7%
Defense	259.4	466.2	(44.4)%
	\$ 278.2	\$ 477.9	(41.8)%

Table of Contents

	For the Year Ended May 31,		
	2015	2014	% Change
Gross Profit:			
Aviation Services			
Commercial	\$ 93.5	\$ 137.6	(32.0)%
Defense	50.3	34.9	44.1%
	\$ 143.8	\$ 172.5	(16.6)%
Expeditionary Services			
Commercial	\$ 1.5	\$ 1.0	50.0%
Defense	14.0	115.4	(87.9)%
	\$ 15.5	\$ 116.4	(86.7)%

Aviation Services Segment

Sales in the Aviation Services segment increased \$84.9 million or 6.9% over the prior year due to a \$65.8 million or 7.2% increase in sales to commercial customers. The increase in sales to commercial customers was 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 our maintenance, repair and overhaul facilities driven by overcapacity in the market which reduced sales by \$13.7 million from the prior period. In addition, a significant engineering services program ended in the second quarter of fiscal 2014 with sales of \$14.6 million in fiscal 2014.

During fiscal 2015, sales in this segment to government and defense customers increased \$19.1 million or 6.1% over the prior year primarily due to higher supply chain volumes in our defense logistics business of \$46.5 million over the prior period. This increase was largely offset by no deliveries of aircraft to government customers in fiscal 2015 compared to the delivery of three aircraft to government customers in fiscal 2014.

Gross profit in the Aviation Services segment decreased \$28.7 million or 16.6%. Gross profit on sales to commercial customers decreased \$44.1 million or 32.0% from the prior year primarily driven by actions related to underperforming inventories and divesting assets no longer part of our strategy going forward. These actions included an impairment charge of \$19.5 million for rotatable assets and inventory supporting certain product lines we are exiting in our landing gear business, the sale of our last two remaining wholly-owned aircraft in our aircraft leasing portfolio resulting in a loss of \$14.8 million, and actions to address underperforming inventories and equipment available for lease resulting in losses in the fourth quarter of fiscal 2015 of \$24.0 million.

The gross profit margin on sales to commercial customers decreased to 9.5% compared to 15.0% in the prior year primarily as a result of the actions discussed above and a decline in gross profit margins in our MRO businesses due to reduced volumes.

Gross profit in this segment on sales to government and defense customers increased \$15.4 million or 44.1% over the prior year with stronger volumes in our defense logistics business contributing the majority of the increase. Gross profit margin increased from 11.2% to 15.2% primarily due to these increased volumes.

Expeditionary Services Segment

Sales in the Expeditionary Services segment decreased \$199.7 million or 41.8% over the prior year period. The decrease in sales was due to a \$155.5 million decrease in sales from our expeditionary airlift services business from the reduction in aircraft positions in Afghanistan. Lower demand for mobility

Table of Contents

products represented the remainder of the decrease in sales in the Expeditionary Services segment as the DoD reduced its purchases of these products due to reduced troop activity.

Gross profit in the Expeditionary Services segment decreased \$100.9 million or 86.7% with the reduction in aircraft positions comprising the majority of the decrease in gross profit. Fiscal 2015 gross profit also included impairment charges of \$8.9 million in our expeditionary airlift services business for inventory, rotatable assets and aircraft which were subsequently sold or currently available for sale. The lower sales volumes at our mobility products business also contributed \$18.4 million to the gross profit decrease.

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

Selling, general and administrative expenses increased \$5.1 million in fiscal 2015 primarily as a result of asset impairment charges on corporate assets of \$3.5 million, severance costs of \$1.7 million and incremental investments in business development activities. These incremental expenses were partially offset by the realization of benefits from the cost control measures implemented by the Company during fiscal 2014.

Earnings from aircraft joint ventures decreased \$2.8 million primarily attributable to the Company's share of the loss from the sale of one aircraft from our aircraft joint venture portfolio.

Income Taxes

Our fiscal 2015 effective income tax rate for continuing operations was 34.3% compared to 32.0% in the prior year period. These effective tax rates reflect the allocation of income tax expense (benefit) across our continuing and discontinued operations. Our fiscal 2014 effective income tax rate for continuing operations included a \$2.6 million reduction in income tax expense related to changes in estimates originally used in the tax provision which were adjusted to actual on the federal income tax return. In addition, our higher taxable income in fiscal 2014 provided a greater tax benefit of \$1.6 million related to the Domestic Production Activities Deduction in accordance with Internal Revenue Code Section 199.

Loss on Extinguishment of Debt and Interest Expense

On April 30, 2015, we redeemed our \$325 million 7.25% Senior Notes due 2022 for \$370.6 million. We recognized a loss on extinguishment of debt of \$44.9 million comprised of a make-whole premium of \$45.6 million and unamortized deferred financing costs of \$6.2 million, partially offset by an unamortized net premium of \$6.9 million. Interest expense decreased \$1.8 million in fiscal 2015 primarily as a result of the redemption of the Senior Notes.

Table of Contents**Results of Operations Fiscal 2014 Compared with Fiscal 2013**

Sales and gross profit for our two business segments for the two years ended May 31, 2014 and 2013 were as follows:

	For the Year Ended May 31,		
	2014	2013	% Change
Sales:			
Aviation Services			
Commercial	\$ 919.9	\$ 989.1	(7.0)%
Defense	311.3	257.8	20.8%
	\$ 1,231.2	\$ 1,246.9	(1.3)%

Expeditionary Services			
Commercial	\$ 11.7	\$ 10.8	8.3%
Defense	466.2	550.2	(15.3)%
	\$ 477.9	\$ 561.0	(14.8)%

	For the Year Ended May 31,		
	2014	2013	% Change
Gross Profit:			
Aviation Services			
Commercial	\$ 137.6	\$ 141.7	(2.9)%
Defense	34.9	3.4	926%
	\$ 172.5	\$ 145.1	18.9%

Expeditionary Services			
Commercial	\$ 1.0	\$	n/a
Defense	115.4	114.4	0.9%
	\$ 116.4	\$ 114.4	1.7%

Aviation Services Segment

Sales in the Aviation Services segment decreased \$15.7 million or 1.3% from the prior year. The decrease in sales was due to a \$69.2 million or 7.0% decrease in sales to our commercial customers primarily attributable to reduced volumes at both our landing gear and engineering services businesses which represented \$18.6 million and \$19.7 million, respectively, of the decrease in sales from fiscal 2013. The remainder of the decrease in commercial sales is primarily attributable to lower sales in our supply chain activities.

During fiscal 2014, sales in this segment to government and defense customers increased \$53.5 million or 20.8% over the prior year. This increase was primarily due to the delivery of three aircraft in fiscal 2014 compared to only one aircraft delivery in fiscal 2013 which contributed

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additional sales of \$24.0 million and higher supply chain volumes which contributed \$43.2 million of the increased sales in fiscal 2014. These increases were partially offset by \$10.7 million in lower sales from our component repair activities.

Gross profit in the Aviation Services segment increased \$27.4 million or 18.9%. Gross profit on sales to commercial customers decreased \$4.1 million or 2.9% from the prior year with the gross profit margin up slightly to 15.0% in fiscal 2014 compared to 14.3% in fiscal 2013. The decrease in gross profit on sales to commercial customers is primarily attributable to reduced volumes at our landing gear business which

Table of Contents

reduced gross profit by \$7.3 million from fiscal 2013. This decrease was partially offset by \$6.2 million of incremental gross profit from our supply chain activities primarily due to the mix of inventories sold.

Gross profit on sales to government and defense customers increased \$31.5 million or 926% over the prior year. Gross profit in fiscal 2013 included a \$29.8 million pre-tax charge on the KC10 support contract which did not recur in fiscal 2014. The fiscal 2013 charge was necessary to reflect lower than expected flight hours of the KC10 aircraft. Our gross profit margin on sales to government and defense customers increased from 1.3% in fiscal 2013 to 11.2% in fiscal 2014. Our fiscal 2014 gross profit on sales to government and defense customers was impacted favorably by improved supply chain margins.

Expeditionary Services Segment

Sales in the Expeditionary Services segment decreased \$83.1 million or 14.8% from the prior year. Sales declined \$44.4 million due to lower demand for mobility products from the DoD due to the drawdown of the war effort in Afghanistan. This drawdown in Afghanistan also impacted our expeditionary airlift services as reduced aircraft contract positions decreased sales \$38.7 million from fiscal 2013.

Gross profit in the Expeditionary Services segment increased \$2.0 million or 1.7% with the gross profit margin increased from 20.4% in fiscal 2013 to 24.4% in fiscal 2014. The increase in the gross profit margin was primarily attributable to an improved availability rate of fully mission capable fixed- and rotary-wing aircraft in our expeditionary airlift services business.

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

Selling, general and administrative expenses increased \$2.3 million or 1.4% in fiscal 2014 compared to fiscal 2013. Selling, general and administrative expenses in fiscal 2013 included a \$9.0 million benefit due to the final settlement of the earn-out payment for the acquisition of Airinmar Holdings Limited in fiscal 2012. Excluding the \$9.0 million benefit, our selling, general and administrative expenses decreased \$6.7 million 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 \$3.7 million, as the prior fiscal year included earnings from the sale of ten aircraft from our aircraft joint venture portfolio.

Income Taxes

Our fiscal 2014 effective income tax rate for continuing operations was 32.0% compared to 34.2% in the prior year period. These effective tax rates reflect the allocation of income tax expense (benefit) across our continuing and discontinued operations. Our fiscal 2014 effective income tax rate for continuing operations included a \$2.6 million reduction in income tax expense related to changes in estimates originally used in the tax provision which were adjusted to actual on the federal income tax return. In addition, our forecasted taxable income in fiscal 2014 provided a tax benefit of \$1.6 million related to the Domestic Production Activities Deduction in accordance with Internal Revenue Code Section 199. Our fiscal 2013 effective income tax rate included a \$1.3 million reduction in income tax expense related to the reduction of our state income tax rate from continued implementation of state tax planning strategies. Our state tax planning strategies included new corporate entities, including the restructure of one of our significant business units.

Liquidity, Capital Resources and Financial Position

As previously discussed, we sold Telair Cargo Group in the fourth quarter of fiscal 2015 which provided net proceeds of \$686.1 million after fees and expenses. These proceeds were utilized to execute our strategy of streamlining our capital structure and returning capital to shareholders. On April 30, 2015,

Table of Contents

we redeemed our \$325 million 7.25% Senior Notes due 2022 for \$370.6 million. On May 29, 2015, we repurchased 4,185,960 shares of our common stock at a price of \$31.90 per share pursuant to a tender offer utilizing \$133.5 million cash on hand. Proceeds from the sale were also used to reduce our outstanding balance on our Credit Agreement from \$185 million at February 28, 2015 to \$50 million at May 31, 2015.

Our operating activities are funded and commitments met through the generation of cash from operations. Periodically, we may raise capital through the issuance of common stock and debt financing in the public and private markets. In addition to these cash sources, our current capital resources include an unsecured 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.

At May 31, 2015, our liquidity and capital resources included cash of \$54.7 million and working capital of \$542.1 million.

On March 24, 2015, we entered into an amendment (the "Amendment") to our Credit Agreement dated April 12, 2011, as amended, with various financial institutions, as lenders and Bank of America, N.A., as administrative agent for the lenders. Under the terms of the Credit Agreement as in effect prior to the Amendment, the aggregate revolving credit commitment amount under the Credit Agreement was \$475 million. The Amendment increased the aggregate revolving credit commitment from \$475 million to \$500 million and provided that the Company, under certain circumstances, may request an increase to the revolving credit commitment by an aggregate amount of up to \$250 million, not to exceed \$750 million in total.

The Amendment also extended the maturity of the Credit Agreement by approximately two years to March 24, 2020; deleted the minimum fixed charge coverage ratio; and added a minimum interest coverage ratio.

Borrowings under the Credit Agreement in effect prior to the Amendment bore interest at the offered Eurodollar 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. The Amendment generally reduced the interest rate on borrowings by 25 basis points. Borrowings under the Credit Agreement subsequent to the Amendment bear interest at the offered Eurodollar Rate plus 100 to 200 basis points based on certain financial measurements if a Eurodollar Rate loan, or at the offered fluctuating Base Rate plus 0 to 100 basis points based on certain financial measurements if a Base Rate loan.

Borrowings outstanding under the Credit Agreement at May 31, 2015 were \$50.0 million and there were approximately \$15.4 million of outstanding letters of credit, which reduced the availability of this facility to \$434.6 million. There are no other terms or covenants limiting the availability of this facility. We also had \$2.7 million available under a foreign line of credit at May 31, 2015.

We intend to retire maturities due in fiscal 2016 through a combination of cash on hand and borrowings under our Credit Agreement.

At May 31, 2015, we complied with all financial and other covenants under each of our financing arrangements.

Table of Contents

Cash Flows Fiscal 2015 Compared with Fiscal 2014

Cash Flows from Operating Activities

Net cash used in operating activities was \$43.0 million in fiscal 2015 compared to cash provided by operating activities of \$139.8 million in fiscal 2014. The decrease of \$182.8 million was primarily attributable to lower net income as a result of a \$100.9 million reduction in gross profit in our Expeditionary Services segment. Our deferred tax benefit also increased \$89.4 million over the prior year primarily resulting from the sale of Telair Cargo Group.

In addition, inventory and accounts receivable increased \$35.0 million and \$7.4 million, respectively, in our supply chain business driven by sales growth in fiscal 2015 of 16.8% over the prior fiscal year. The sales growth was principally due to new contract wins announced in the second half of fiscal 2014. These increased uses of cash were partially offset by less investment during fiscal 2015 in equipment on or available for long-term lease as fiscal 2014 included an acquisition of equipment to support new supply chain programs.

Cash Flows from Investing Activities

Net cash provided by investing activities was \$689.2 million in fiscal 2015 compared to a use of cash of \$40.9 million in fiscal 2014. The increase of \$730.1 million over the comparable prior period was primarily attributable to the proceeds received from the sale of the Telair Cargo Group of \$686.1 million after fees and expenses and an advance on a sale-leaseback for two aircraft from our expeditionary airlift business of \$40.3 million.

Cash Flows from Financing Activities

Net cash used in financing activities was \$678.1 million in fiscal 2015 compared to \$85.9 million in fiscal 2014. The decrease of \$592.2 million was primarily attributable to the use of our proceeds from our sale of the Telair Cargo Group to reduce our long-term borrowings by \$394.8 million, including the redemption of our \$325 million 7.25% Senior Notes for \$370.6 million. We also reduced the outstanding balance on our revolving Credit Agreement by \$80 million during fiscal 2015. Proceeds from the sale of the Telair Cargo Group were also used to repurchase common stock via a tender offer and other open market purchases which used \$151.5 million of cash including fees and expenses.

Cash Flows Fiscal 2014 Compared with Fiscal 2013

Cash Flows from Operating Activities

Net cash provided from operating activities was \$139.8 million in fiscal 2014 compared to \$162.9 million in fiscal 2013. The decrease of \$23.1 million was primarily attributable to investments in equipment on or available for long-term lease partially offset by higher earnings.

Equipment on or available for long-term lease used \$41.7 million of cash in fiscal 2014 compared to providing cash of \$0.8 million in fiscal 2013. Equipment on or available for long-term lease increased to support new supply chain programs in the Aviation Services segment. In addition, inventories utilized \$47.9 million of cash in fiscal 2014 compared to providing \$16.1 million of cash in fiscal 2013. The increased utilization of cash for inventories was also attributable to the growth in new customer programs and was largely offset by an increase in accounts payable which provided cash of \$20.1 million in fiscal 2014 compared to a utilization of cash of \$50.7 million in fiscal 2013.

Cash Flows from Investing Activities

Net cash used in investing activities was \$40.9 million in fiscal 2014 compared to \$32.8 million in fiscal 2013 representing an increase of \$8.1 million. This increase over the comparable prior period was primarily attributable to higher proceeds in fiscal 2013 over fiscal 2014 from a return of capital from our aircraft joint ventures. This was partially offset by a reduction in capital expenditures which utilized \$26.5 million of cash in fiscal 2014 compared to \$37.6 million in fiscal 2013.

Table of Contents*Cash Flows from Financing Activities*

Net cash used in financing activities was \$85.9 million in fiscal 2014 compared to \$123.7 million in fiscal 2013. The decrease of \$37.8 million was primarily attributable to higher repayments of borrowings in fiscal 2013 compared to fiscal 2014. We also repurchased \$13.6 million less treasury stock in fiscal 2014 as compared to fiscal 2013.

Contractual Obligations and Off-Balance Sheet Arrangements

A summary of contractual cash obligations and off-balance sheet arrangements as of May 31, 2015 is as follows:

	Total	Payments Due by Period					After Fiscal 2021
		Due in Fiscal 2016	Due in Fiscal 2017	Due in Fiscal 2018	Due in Fiscal 2019	Due in Fiscal 2020	
On Balance Sheet:							
Debt	\$ 85.8	\$ 60.8	\$	\$	\$ 25.0	\$	\$
Bank borrowings	70.0	10.0	10.0			50.0	
Interest ¹	7.6	2.9	1.7	1.4	0.9	0.7	
Off Balance Sheet:							
Facilities and equipment operating leases	103.9	19.7	15.6	11.3	9.9	9.4	38.0
Purchase obligations ²	244.7	222.6	15.2	4.1	0.1	0.1	2.6
Pension contribution	3.5	3.5					

Notes:

¹ Interest associated with variable rate debt was determined using the interest rate in effect on May 31, 2015.

² Purchase obligations arise in the ordinary course of business and represent a binding commitment to acquire inventory, including raw materials, parts, and components, as well as equipment to support the operations of our business.

We routinely issue letters of credit and performance bonds in the ordinary course of business. These instruments are typically issued in conjunction with insurance contracts or other business requirements. The total of these instruments outstanding at May 31, 2015 was \$15.4 million.

Critical Accounting Policies and Significant Estimates

Our Consolidated Financial Statements are prepared in conformity with accounting principles generally accepted in the United States. Management has made estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent liabilities to prepare the Consolidated Financial Statements. The most significant estimates made by management include those related to assumptions used in assessing goodwill impairment, adjustments to reduce the value of inventories and certain rotables, revenue recognition, and assumptions used in determining pension plan obligations. Accordingly, actual results could differ materially from those estimates. The following is a summary of the accounting policies considered critical by management.

Goodwill and Other Intangible Assets

Under accounting standards for goodwill and other intangible assets, goodwill and other intangible assets deemed to have indefinite lives are not amortized, but are subject to annual impairment tests. We review and evaluate our goodwill and indefinite life intangible assets for potential impairment at a minimum annually, on May 31, or more frequently if circumstances indicate that impairment is possible.

Table of Contents

The accounting standards for goodwill allow for the assessment of qualitative factors, such as macroeconomic conditions, industry and market conditions and entity relevant events or circumstances to determine whether it is more likely or not that the fair value of a reporting unit is less than its carrying amount. We did not utilize a qualitative assessment approach as we chose instead to complete the quantitative two-step testing process for each reporting unit. In the first step, we compare the fair value of each reporting unit with the carrying value of the reporting unit, including goodwill. If the estimated fair value of the reporting unit is less than the carrying value of the reporting unit, we would be required to complete a second step to determine the amount of goodwill impairment. The second step of the test requires the allocation of the reporting unit's fair value to its assets and liabilities, including any unrecognized intangible assets, in a hypothetical analysis that calculates the implied fair value of goodwill as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill is less than the carrying value, the difference is recorded as an impairment loss.

As of May 31, 2015, we have five reporting units as defined by Accounting Standards Codification ("ASC") 350, *Intangibles Goodwill and Other* with only four of the reporting units' assigned goodwill. Our four reporting units with goodwill include two in our Aviation Services segment (Supply Chain and Maintenance, Repair, and Overhaul) and two in our Expeditionary Services segment (Airlift and Mobility). These reporting units align with our new segments and organizational structure which was established in the third quarter of fiscal 2015 concurrent with the decision to divest our Telair Cargo Group and PSM businesses. The reporting units' fair values were all in excess of their carrying values at the time of the realignment which included a reallocation of certain goodwill due to the sale of the Telair Cargo Group and planned disposition of the PSM businesses.

We estimate the fair value of each reporting unit using an income approach based on discounted cash flows. The assumptions we used to estimate the fair value of our reporting units are based on historical performance as well as forecasts derived from our current business plan. The discounted cash flow valuation approach is highly dependent on certain components of our business plan including estimates of future sales, operating income, depreciation and amortization, income taxes, changes in working capital, and capital expenditures. All of these factors are affected by economic conditions related to the aerospace and defense industries as well as conditions in the global capital markets.

In addition to the business plan specific assumptions, the expected long-term cash flow growth rates and weighted average cost of capital ("WACC") are significant assumptions in the valuations. The WACC for each reporting unit was comprised of a weighted blend of an estimated rate of return on equity (based on publicly traded companies with business and economic risk characteristics comparable to each of our reporting units, i.e., "Market Participants"), risk-free rate of return based on long-term U.S. Treasury Bond rates, an equity risk premium, and an after-tax rate of return on Market Participants' debt. There were no significant changes to the underlying methods used in fiscal 2015 as compared to the prior year reporting unit valuations.

Step one of the goodwill impairment tests was completed for all our reporting units with assigned goodwill and the estimated fair value for each reporting unit exceeding its net asset carrying value at our annual measurement date of May 31, 2015. Accordingly, there was no indication of impairment and the second step was not performed.

We also evaluate the sensitivity of the discounted cash flow valuations by assessing the impact of changes in certain assumptions on the estimated fair value of each reporting unit by increasing the WACC or reducing the expected long-term cash flow growth rates. We also perform sensitivity analysis on our business plan assumptions including sales and profitability. All of our reporting units would have had fair values in excess of their carrying values under all our sensitivity scenarios.

Table of Contents

Inventories

Inventories are valued at the lower of cost or market (estimated net realizable value). Cost is determined by the specific identification, average cost or first-in, first-out methods. Write-downs are made for excess and obsolete inventories and inventories that have been impaired as a result of industry conditions. We have utilized certain assumptions when determining the market value of inventories, such as inventory quantities and aging, historical sales of inventory, current and expected future aviation usage trends, replacement values, expected future demand, and historical scrap recovery rates. Reductions in demand for certain of our inventories or declining market values, as well as differences between actual results and the assumptions utilized by us when determining the market value of our inventories, could result in the recognition of impairment charges in future periods.

Due to the remote geographic locations where we operate our expeditionary airlift business and the nature of our fixed- and rotary-wing aircraft, carrying large quantities of aircraft support parts is necessary in order to ensure availability of parts for servicing our fleet of aircraft. We record an excess and obsolete reserve for parts when our quantity on hand exceeds our forecasted needs or when the parts have been deemed obsolete or beyond economical repair. In addition, changes in the utilization of our fleet can affect estimates associated with our provision for excess and obsolete parts.

Revenue Recognition

Certain supply chain management programs that 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.

Sales and related cost of sales for certain large airframe maintenance contracts and performance-based logistics programs are recognized using contract accounting under the percentage of completion method in accordance with ASC 605-35, *Construction Type and Production Type Contracts*. In applying the percentage of completion method, we use the cost-to-cost method based on the ratio of actual costs incurred to total estimated costs to be incurred.

In connection with these contracts and programs, we are required to make certain judgments and estimates, including estimated revenues and costs, as well as inflation and the overall profitability of the program and the relative fair value of each element of the arrangement. Key assumptions involved in our contract accounting include future labor costs and efficiencies, overhead costs, and ultimate timing of product delivery. Differences may occur between the judgments and estimates made by management and actual program results.

Impairment of Long-Lived Assets

We are required to test for impairment of long-lived assets whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable from its undiscounted cash flows. When applying accounting standards addressing impairment to long-lived assets, we have utilized certain assumptions to estimate future undiscounted cash flows, including current and future sales volumes or lease rates, expected changes to cost structures, lease terms, residual values, market conditions, and trends impacting future demand. Differences between actual results and the assumptions utilized by us when determining undiscounted cash flows could result in future impairments of long-lived assets.

We maintain a significant inventory of rotatable parts and equipment to service customer aircraft and components. Portions of that inventory are used parts that are often exchanged with parts removed from aircraft or components, and are reworked to a useable condition. We may have to recognize an impairment

Table of Contents

of our rotatable parts and equipment if we discontinue using or servicing certain aircraft models or if an older aircraft model is phased-out in the industry.

Pension Plans

The liabilities and net periodic cost of our pension plans are determined utilizing several actuarial assumptions, the most significant of which are the discount rate and the expected long-term rate of return on plan assets.

AAR uses a discount rate to measure our benefit obligation for our pension plans. This discount rate will be used in calculating the net periodic benefit cost for these plans for fiscal 2016. We used a broad population of Aa-rated corporate bonds as of May 31, 2015 to determine the discount rate assumption. All bonds were denominated in U.S. Dollars, with a minimum outstanding of \$50.0 million. This population of bonds was narrowed from a broader universe of over 500 Moody's Aa-rated, non-callable (or callable with make-whole provisions) bonds by eliminating the top 10th percentile and the bottom 40th percentile to adjust for any pricing anomalies and to represent the bonds we would most likely select if we were to actually annuitize our pension plan liabilities. This portfolio of bonds was used to generate a yield curve and associated spot rate curve to discount the projected benefit payments for the domestic plans. The discount rate is the single level rate that produces the same result as the spot rate curve.

We establish the long-term asset return assumption based on a review of historical compound average asset returns, both company-specific and relating to the broad market, as well as analysis of current market and economic information and future expectations. The current asset return assumption is supported by historical market experience for both our actual and target asset allocation. In calculating the net pension cost, the expected return on assets is applied to a calculated value on plan assets, which recognizes changes in the fair value of plan assets in a systematic manner over five years. The difference between this expected return and the actual return on plan assets is a component of the total net unrecognized gain or loss and is subject to amortization in the future.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") 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 also supersedes 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, however the FASB issued a proposed ASU on April 29, 2015 which would defer the effective date of the new standard for one year. We are currently evaluating the impact of the adoption of this new standard on our consolidated financial statements.

In April 2014, the FASB issued ASU No. 2014-08, *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity* which requires that a disposal representing a strategic shift that has or will have a major effect on an entity's financial results or a business activity classified as held for sale should be reported as discontinued operations. The amendments also expand the disclosure requirements for discontinued operations and add new disclosures for individually significant dispositions that do not qualify as discontinued operations. The Company adopted this guidance on June 1, 2015 which will result in expanded disclosures related to the income statement and cash flow activities for our discontinued operations.

In April 2015, the FASB issued ASU No. 2015-03, *Simplifying the Presentation of Debt Issuance Costs*. This standard amends existing guidance to require the presentation of debt issuance costs in the balance sheet as a deduction from the carrying amount of the related debt liability instead of a deferred charge.

Table of Contents

This new standard will be effective for us beginning June 1, 2016 with early adoption permitted. We are currently evaluating the impact of the adoption of this new standard on our consolidated financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK
(Dollars in millions)

Our exposure to market risk includes fluctuating interest rates under our credit agreements, changes in foreign exchange rates, and credit losses on accounts receivable. See Note 1 of Notes to Consolidated Financial Statements for a discussion on accounts receivable exposure.

We are exposed to the risk that our earnings and cash flows could be adversely impacted by fluctuations in interest rates. We manage interest costs by using a mix of fixed- and floating-rate debt. We previously utilized two derivative financial instruments to manage our variable interest rate exposure over a medium- to long-term period which included a floating-to-fixed interest rate swap and an interest rate cap agreement. In connection with the Amendment of our Credit Agreement, we settled our floating-to-fixed interest rate swap and interest rate cap agreements in the fourth quarter of fiscal 2015 for approximately \$2.6 million.

A 10 percent increase in the average interest rate affecting our financial instruments, including the average outstanding balance of our debt obligations and related derivatives, would not have had a significant impact on our pre-tax income during fiscal 2015.

Revenues and expenses of our foreign operations are translated at average exchange rates during the year, and balance sheet accounts are translated at year-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.

On March 26, 2015, we sold our Telair Cargo Group which comprised the majority of our foreign operations and as a result, a hypothetical 10 percent devaluation of the U.S. dollar against foreign currencies would not have had a material impact on our financial position or continuing operations.

Table of Contents

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
AAR CORP.:

We have audited the accompanying consolidated balance sheets of AAR CORP. and subsidiaries as of May 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income (loss), changes in equity and cash flows for each of the years in the three-year period ended May 31, 2015. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of AAR CORP. and subsidiaries as of May 31, 2015 and 2014, and the results of their operations, and their cash flows for each of the years in the three-year period ended May 31, 2015, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), AAR CORP.'s internal control over financial reporting as of May 31, 2015, based on criteria established in Internal Control Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated July 15, 2015 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Chicago, Illinois
July 15, 2015

Table of Contents

AAR CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

	For the Year Ended May 31,		
	2015	2014	2013
	(In millions, except per share data)		
Sales:			
Sales from products	\$ 891.4	\$ 901.3	\$ 900.6
Sales from services	702.9	807.8	907.3
	1,594.3	1,709.1	1,807.9
Costs and operating expenses:			
Cost of products	836.5	794.0	840.9
Cost of services	598.5	626.2	707.5
Selling, general and administrative	171.4	166.3	164.0
	1,606.4	1,586.5	1,712.4
Earnings from joint ventures	0.2	3.0	6.7
Operating income (loss)	(11.9)	125.6	102.2
Loss on extinguishment of debt	(44.9)		(0.3)
Interest expense	(26.5)	(28.3)	(29.1)
Interest income	0.3	1.5	1.4
Income (Loss) from continuing operations before provision for income taxes	(83.0)	98.8	74.2
Provision for income tax (benefit)	(28.5)	31.6	25.4
Income (Loss) from continuing operations attributable to AAR	(54.5)	67.2	48.8
Discontinued operations:			
Operating income (loss)	(1.5)	6.5	8.1
Gain on disposal	198.6		
Impairment charges	(57.5)		
Provision for income taxes	74.7	0.5	1.4
Income from discontinued operations	64.9	6.0	6.7
Income attributable to noncontrolling interest from discontinued operations	(0.2)	(0.3)	(0.5)
Income from discontinued operations attributable to AAR	64.7	5.7	6.2
Net income attributable to AAR	\$ 10.2	\$ 72.9	\$ 55.0
Earnings per share basic:			
Earnings (Loss) from continuing operations	\$ (1.40)	\$ 1.70	\$ 1.23
Earnings from discontinued operations	1.66	0.15	0.15
Earnings per share basic	\$ 0.26	\$ 1.85	\$ 1.38

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Earnings per share diluted:						
Earnings (Loss) from continuing operations	\$	(1.40)	\$	1.68	\$	1.23
Earnings from discontinued operations		1.64		0.15		0.15
Earnings per share diluted	\$	0.24	\$	1.83	\$	1.38

The accompanying notes to consolidated financial statements
are an integral part of these statements.

Table of Contents**AAR CORP. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

	For the Year Ended May 31,		
	2015	2014	2013
	(In millions)		
Net income attributable to AAR and noncontrolling interest	\$ 10.4	\$ 73.2	\$ 55.5
Other comprehensive income, net of tax:			
Currency translation adjustments, net of tax	(7.8)	14.0	8.7
Derivative instruments, net of tax expense of \$1.4 in 2015, \$0.4 in 2014, and \$0.3 in 2013	2.6	0.7	0.6
Unrecognized pension and post retirement costs, net of tax expense (benefit) of (\$3.2) in 2015, (\$0.8) in 2014, and \$1.8 in 2013	(5.9)	(1.5)	3.4
Total other comprehensive income (loss), net of tax	(11.1)	13.2	12.7
Comprehensive income (loss)	(0.7)	86.4	68.2
Less: Comprehensive income attributable to noncontrolling interests	(0.2)	(0.3)	(0.5)
Comprehensive income (loss) attributable to AAR	\$ (0.9)	\$ 86.1	\$ 67.7

The accompanying notes to consolidated financial statements
are an integral part of these statements.

Table of Contents

**AAR CORP. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS**

ASSETS

	May 31,	
	2015	2014
	(In millions)	
Current assets:		
Cash and cash equivalents	\$ 54.7	\$ 89.2
Accounts receivable	229.0	283.1
Inventories	456.0	495.3
Rotable spares and equipment on or available for short-term lease	110.7	137.6
Assets of discontinued operations	17.0	
Deposits, prepaids and other	28.4	81.6
Deferred tax assets	58.3	24.6
Total current assets	954.1	1,111.4
Property, plant and equipment, at cost:		
Land	3.4	9.4
Buildings and improvements	86.4	102.4
Aircraft, equipment, furniture and fixtures	523.5	627.4
	613.3	739.2
Accumulated depreciation	(398.5)	(424.3)
	214.8	314.9
Other assets:		
Goodwill	123.5	261.7
Intangible assets, net	36.7	165.4
Equipment on or available for long-term lease	80.2	98.4
Capitalized program development costs		112.2
Investment in joint ventures	20.5	29.9
Other	85.2	100.1
	346.1	767.7
	\$ 1,515.0	\$ 2,194.0

The accompanying notes to consolidated financial statements
are an integral part of these statements.

Table of Contents

**AAR CORP. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS**

LIABILITIES AND EQUITY

	May 31,	
	2015	2014
	(In millions)	
Current liabilities:		
Current maturities of long-term debt	\$ 69.0	\$ 69.7
Accounts and trade notes payable	142.3	171.1
Accrued liabilities	200.7	161.3
Total current liabilities	412.0	402.1
Long-term debt, less current maturities	85.0	564.3
Deferred tax liabilities	104.6	156.7
Other liabilities and deferred income	68.3	70.2
	257.9	791.2
Equity:		
Preferred stock, \$1.00 par value, authorized 250,000 shares; none issued		
Common stock, \$1.00 par value, authorized 100,000,000 shares; issued 44,895,934 and 44,674,186 shares at cost, respectively	44.9	44.7
Capital surplus	442.6	436.4
Retained earnings	644.3	646.0
Treasury stock, 9,473,058 and 5,113,939 shares at cost, respectively	(246.3)	(98.3)
Accumulated other comprehensive loss	(40.4)	(29.3)
Total AAR stockholders' equity	845.1	999.5
Noncontrolling interest		1.2
Total equity	845.1	1,000.7
	\$ 1,515.0	\$ 2,194.0

The accompanying notes to consolidated financial statements
are an integral part of these statements.

Table of Contents

AAR CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
FOR THE THREE YEARS ENDED MAY 31, 2015

(In millions)

	Common		Capital		Retained		Treasury		Accumulated Other Comprehensive Total AAR		Noncontrolling		Total	
	Stock	Surplus	Earnings	Stock	Income	(Loss)	Equity	Equity	Interest	Equity	Equity	Equity	Equity	Equity
Balance, May 31, 2012	\$ 44.8	\$ 423.6	\$ 541.8	\$ (90.4)	\$ (55.2)		\$ 864.6	\$ 1.4		\$ 866.0				
Net income			55.0				55.0	0.5		55.5				
Cash dividends			(11.9)				(11.9)	(1.0)		(12.9)				
Stock option activity		2.8		1.7			4.5			4.5				
Restricted stock activity	(0.1)	4.7		3.2			7.8			7.8				
Repurchase of shares				(14.6)			(14.6)			(14.6)				
Equity portion of bond repurchase		0.5					0.5			0.5				
Other comprehensive income, net of tax					12.7		12.7			12.7				
Balance, May 31, 2013	\$ 44.7	\$ 431.6	\$ 584.9	\$ (100.1)	\$ (42.5)		\$ 918.6	\$ 0.9		\$ 919.5				
Net income			72.9				72.9	0.3		73.2				
Cash dividends			(11.8)				(11.8)			(11.8)				
Stock option activity		2.8		5.0			7.8			7.8				
Restricted stock activity		2.0		(2.2)			(0.2)			(0.2)				
Repurchase of shares				(1.0)			(1.0)			(1.0)				
Other comprehensive income, net of tax					13.2		13.2			13.2				
Balance, May 31, 2014	\$ 44.7	\$ 436.4	\$ 646.0	\$ (98.3)	\$ (29.3)		\$ 999.5	\$ 1.2		\$ 1,000.7				
Net income			10.2				10.2	0.2		10.4				
Cash dividends			(11.9)				(11.9)	(0.6)		(12.5)				
Stock option activity		2.1		4.2			6.3			6.3				
Restricted stock activity	0.2	4.7		(0.7)			4.2			4.2				
Repurchase of shares				(151.5)			(151.5)			(151.5)				
Other		(0.6)					(0.6)	(0.8)		(1.4)				
Other comprehensive loss, net of tax					(11.1)		(11.1)			(11.1)				
Balance, May 31, 2015	\$ 44.9	\$ 442.6	\$ 644.3	\$ (246.3)	\$ (40.4)		\$ 845.1			\$ 845.1				

The accompanying notes to consolidated financial statements
are an integral part of these statements.

Table of Contents

AAR CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Year Ended May 31,		
	2015	2014	2013
	(in millions)		
Cash flows provided from operating activities:			
Net income attributable to AAR and noncontrolling interest	\$ 10.4	\$ 73.2	\$ 55.5
Adjustments to reconcile net income attributable to AAR and noncontrolling interest to net cash provided from operating activities:			
Depreciation and intangible amortization	69.1	80.4	79.7
Impairment charges	84.6		
Amortization of program development costs	31.6	6.3	
Amortization of stock-based compensation	7.8	8.7	11.1
Amortization of debt discount	2.7	5.3	9.6
Amortization of overhaul costs	23.2	33.0	28.9
Deferred tax provision (benefit)	(79.8)	9.6	29.5
Gain on sale of business	(198.6)		
Loss on extinguishment of debt	44.9		0.3
Earnings from joint ventures	(0.4)	(3.1)	(6.8)
Changes in certain assets and liabilities, net of acquisitions:			
Accounts receivable	(28.3)	16.7	6.0
Inventories	(43.2)	(47.9)	16.1
Rotable spares and equipment on or available for short-term lease	6.6	11.3	10.4
Equipment on or available for long-term lease	6.2	(41.7)	0.8
Accounts and trade notes payable	(4.0)	20.1	(50.7)
Accrued and other liabilities	28.1	4.3	11.8
Other, primarily program and overhaul costs	(3.9)	(36.4)	(39.3)
Net cash provided from (used in) operating activities	(43.0)	139.8	162.9
Cash flows used in investing activities:			
Property, plant and equipment expenditures	(46.3)	(26.5)	(37.6)
Proceeds from sale of assets	6.6	2.0	11.8
Proceeds from sale of business	686.1		
Proceeds from sale-leaseback advance	40.3		
Payments for acquisitions	(1.0)	(15.3)	(21.3)
Proceeds from aircraft joint ventures	4.0	(0.2)	15.4
Other	(0.5)	(0.9)	(1.1)
Net cash provided by (used in) investing activities	689.2	(40.9)	(32.8)
Cash flows (used in) provided from financing activities:			
Short-term borrowings (repayments), net	(80.0)	10.0	(160.0)
Proceeds from borrowings			181.8
Reduction in long-term borrowings	(394.8)	(88.9)	(114.3)
Cash dividends	(12.5)	(11.8)	(12.8)
Premium paid on early retirement of debt	(45.6)		
Purchase of treasury stock	(151.5)	(1.0)	(14.6)
Stock option exercises	6.5	5.1	1.1
Other	(0.2)	0.7	(4.9)
Net cash used in financing activities	(678.1)	(85.9)	(123.7)
Effect of exchange rate changes on cash	(2.6)	0.9	1.2

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Increase (Decrease) in cash and cash equivalents	(34.5)	13.9	7.6
Cash and cash equivalents, beginning of year	89.2	75.3	67.7
Cash and cash equivalents, end of year	\$ 54.7	\$ 89.2	\$ 75.3

The accompanying notes to consolidated financial statements
are an integral part of these statements.

Table of Contents

AAR CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions, except per share amounts)

1. Summary of Significant Accounting Policies

Description of Business

AAR CORP. is a diversified provider of services and products to the worldwide commercial aviation and government and defense markets. Services and products include: aviation supply chain and parts support programs; maintenance, repair and overhaul of aircraft and landing gear; design and manufacture of specialized pallets, shelters, and containers; expeditionary airlift services; aircraft modifications and aircraft and engine sales and leasing. We serve commercial, defense and governmental aircraft fleet operators, original equipment manufacturers, and independent service providers around the world, and various other domestic and foreign military customers.

Principles of Consolidation

The accompanying Consolidated Financial Statements include the accounts of the Company and its majority-owned subsidiaries after elimination of intercompany accounts and transactions. The equity method of accounting is used for investments in other companies in which we have significant influence; generally this represents common stock ownership of at least 20% and not more than 50% (see Note 10 for a discussion of aircraft joint ventures).

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 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 large airframe maintenance contracts and performance-based logistics programs are recognized by the percentage of completion method, based on the relationship of costs incurred to date to the estimated total costs. 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.

Table of Contents

AAR CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollars in millions, except per share amounts)

1. Summary of Significant Accounting Policies (Continued)

Included in accounts receivable as of May 31, 2015 and 2014, are \$21.1 million and \$19.7 million, respectively, of unbilled accounts receivable related to our 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 consolidated balance sheet as of May 31, 2015 and 2014, are \$7.5 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 amounts of revenue recognized by us driven by costs incurred under the flight hour portion of the program, compared to what was billed.

Pursuant to U.S. generally accepted accounting principles, we have to assess the recoverability of the costs in excess of amounts billed by projecting future performance of the flight hour portion of the contract, including an estimate of future flight hours and costs over the life of the program. In fiscal 2013, we established cost savings targets to reduce program spend over the life of the program and we had been successful in achieving these targets. However, beginning in the second half of fiscal 2013 we experienced a decrease in flight hour revenue. This decrease was caused by a 28% decline in flight hours flown primarily due to lower operations tempo. As a result of this unexpected and significant decline in flight hour revenue and a revised forecast indicating lower usage in the future for the fleet, we lowered the revenue and profitability forecast for the flight hour portion of the contract during the fourth quarter of fiscal 2013 resulting in a \$29.8 million pre-tax charge. This revised forecast results in a 0% margin over the remaining life of the flight-hour program.

No additional adjustments have been recorded in fiscal 2015 or 2014 based on the flight hours and costs incurred to date as well as future expectations for the program. We recorded 0% margin in fiscal 2015 and 2014 on the flight-hour portion of the contract, which resulted in revenue of \$46.5 million and \$42.4 million in fiscal 2015 and 2014, respectively. We expect to recover the May 31, 2015 balance of the costs in excess of amounts billed of \$7.5 million through projected future billings in excess of forecasted costs over the life of the program.

Notwithstanding the foregoing, we reserve all our rights under the KC10 supply agreement, at law and in equity, including our rights to recover past and future revenues and expenses associated with the program.

Allowance for Doubtful Accounts

We maintain an allowance for doubtful accounts to reflect the expected uncollectibility of accounts receivable based on past collection history and specific risks identified among uncollected accounts. In determining the required allowance, we consider factors such as general and industry-specific economic conditions, customer credit history, and our customers' current and expected future financial performance. The majority of our customers are recurring customers with an established payment history. Certain customers are required to undergo an extensive credit check prior to delivery of products or services.

Table of Contents

AAR CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollars in millions, except per share amounts)

1. Summary of Significant Accounting Policies (Continued)

Goodwill and Other Intangible Assets

In accordance with Accounting Standards Codification ("ASC") 350, *Intangibles - Goodwill and Other*, goodwill and other intangible assets deemed to have indefinite lives are not amortized, but are subject to annual impairment tests. We review and evaluate our goodwill and indefinite life intangible assets for potential impairment at a minimum annually, on May 31, or more frequently if circumstances indicate that impairment is possible. We use a two-step process to evaluate goodwill for impairment. In the first step, we compare the fair value of each reporting unit with the carrying value of the reporting unit, including goodwill. If the estimated fair value of the reporting unit is less than the carrying value of the reporting unit, we would be required to complete a second step to determine the amount of goodwill impairment. The second step of the test requires the allocation of the reporting unit's fair value to its assets and liabilities, including any unrecognized intangible assets, in a hypothetical analysis that calculates the implied fair value of goodwill as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill is less than the carrying value, the difference is recorded as an impairment loss.

We estimate the fair value of each reporting unit using both an income approach based on discounted cash flows and a market approach based on a multiple of earnings. The assumptions we used to estimate the fair value of our reporting units are based on historical performance, as well as forecasts used in our current business plan and require considerable management judgment. We use a discount rate based on our consolidated weighted average cost of capital which is adjusted for each of our reporting units based on their specific risk and size characteristics. The fair value measurements used for our goodwill impairment testing use significant unobservable inputs, which reflect our own assumptions about the inputs that market participants would use in measuring fair value. The fair value of our reporting units is also impacted by our overall market capitalization and may be impacted by volatility in our stock price and assumed control premium, among other items.

As of May 31, 2015, we have five reporting units as defined by ASC 350. Step one of the impairment test was completed for the reporting units with assigned goodwill and the estimated fair value for each reporting unit exceeded its net asset carrying value. Accordingly, there was no indication of impairment and the second step was not performed.

In connection with the change in reportable segments discussed in Note 13 Business Segment Information and the divestitures discussed in Note 2 Discontinued Operations, we reallocated goodwill

Table of Contents

AAR CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollars in millions, except per share amounts)

1. Summary of Significant Accounting Policies (Continued)

across our new segments based on a relative fair value basis. Changes in the carrying amount of goodwill by segment for fiscal 2015 and 2014 are as follows:

	Aviation Services	Expeditionary Services	Discontinued Operations	Total
Balance as of May 31, 2013	\$ 73.7	\$ 45.0	\$ 136.9	\$ 255.6
Acquisition			0.3	0.3
Foreign currency translation adjustments	2.0		3.8	5.8
Balance as of May 31, 2014	75.7	45.0	141.0	261.7
Reallocation of goodwill		4.7	(4.7)	
Businesses sold or assets held for sale			(136.3)	(136.3)
Foreign currency translation adjustments	(1.9)			(1.9)
Balance as of May 31, 2015	\$ 73.8	\$ 49.7	\$	\$ 123.5

Intangible assets with finite useful lives are amortized on a straight-line basis over their estimated useful lives. Intangible assets, other than goodwill, are comprised of the following:

	Gross	May 31, 2015 Accumulated Amortization	Net
Amortizable intangible assets:			
Customer relationships	\$ 23.4	\$ (9.0)	\$ 14.4
Developed technology	8.0	(3.5)	4.5
Lease agreements	21.5	(8.7)	12.8
FAA certificates	5.0	(1.3)	3.7
	57.9	(22.5)	35.4
Unamortized intangible assets:			
Trademarks	1.3		1.3
	\$ 59.2	\$ (22.5)	\$ 36.7

	Gross	May 31, 2014 Accumulated Amortization	Net
Amortizable intangible assets:			
Customer relationships	\$ 124.0	\$ (22.9)	\$ 101.1
Developed technology	32.8	(4.8)	28.0

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Lease agreements	21.5	(7.5)	14.0
FAA certificates	5.0	(1.0)	4.0
	183.3	(36.2)	147.1
Unamortized intangible assets:			
Trademarks	18.3		18.3
	\$ 201.6	\$ (36.2)	\$ 165.4

Table of Contents

AAR CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollars in millions, except per share amounts)

1. Summary of Significant Accounting Policies (Continued)

Customer relationships are being amortized over 10-20 years, developed technology is being amortized over 7-10 years, the lease agreements are being amortized over 18 years, and the FAA certificates are being amortized over 20 years. Amortization expense recorded during fiscal 2015, 2014 and 2013 was \$4.6 million, \$4.7 million, and \$7.7 million, respectively. The estimated aggregate amount of amortization expense for intangible assets in each of the next five fiscal years is \$4.4 million in 2016, \$4.4 million in 2017, \$4.4 million in 2018, \$3.8 million in 2019 and \$3.5 million in 2020.

Foreign Currency

Our foreign subsidiaries utilize the local currency as their functional currency. All balance sheet accounts of foreign subsidiaries transacting business in currencies other than the U.S. dollar are translated at year-end exchange rates. Revenues and expenses are translated at average exchange rates during the year. Translation adjustments are excluded from the results of operations and are recorded in stockholders' equity as a component of accumulated other comprehensive loss until such subsidiaries are liquidated.

Cash and Cash Equivalents

Cash and cash equivalents consist of highly liquid instruments which have original maturities of three months or less when purchased.

Financial Instruments and Concentrations of Market or Credit Risk

Financial instruments that potentially subject us to concentrations of market or credit risk consist principally of trade receivables. While our trade receivables are diverse and represent a number of entities and geographic regions, the majority are with the U.S. Department of Defense and its contractors and entities in the aviation industry. Accounts receivable due from the U.S. Department of Defense were \$39.2 million and \$50.5 million at May 31, 2015 and 2014, respectively. Additionally, included in accounts receivable as of May 31, 2015 and 2014, are \$41.1 million and \$48.7 million, respectively, of accounts receivable from a large defense contractor. We perform regular evaluations of customer payment experience, current financial condition, and risk analysis. We may require collateral in the form of security interests in assets, letters of credit, and/or obligation guarantees from financial institutions for transactions executed on other than normal trade terms.

The carrying amounts of cash and cash equivalents, accounts receivable, and accounts and trade notes payable approximate fair value because of the short-term maturity of these instruments. The carrying value of long-term debt bearing a variable interest rate approximates fair value.

Fair value estimates are made at a specific point in time based on relevant market information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Inventories

Inventories are valued at the lower of cost or market (estimated net realizable value). Cost is determined by the specific identification, average cost, or first-in, first-out methods. From time-to-time, we purchase aircraft and engines for disassembly to individual parts and components. Costs are assigned to

Table of Contents**AAR CORP. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Dollars in millions, except per share amounts)****1. Summary of Significant Accounting Policies (Continued)**

these individual parts and components utilizing list prices from original equipment manufacturers and recent sales history.

The following is a summary of inventories:

	May 31,	
	2015	2014
Raw materials and parts	\$ 43.1	\$ 114.1
Work-in-process	18.1	57.5
Aircraft and engine parts, components and finished goods	337.0	297.3
Aircraft held for sale and related support parts	57.8	26.4
	\$ 456.0	\$ 495.3

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. We had eleven aircraft held for sale comprised of five fixed-wing and six rotary-wing aircraft at May 31, 2015 and nine aircraft held for sale comprised of five fixed-wing and four rotary-wing aircraft at May 31, 2014. During fiscal 2015, we recognized impairment charges of \$8.9 million reflecting the decrease in fair value for certain aircraft held for sale and related rotatable assets.

During the fourth quarter of fiscal 2015, we entered into a sale-leaseback transaction for our two S-92 rotary-wing aircraft. We received proceeds of \$40.3 million in fiscal 2015 which have been deferred as a sale-leaseback advance pending completion of the sale transaction, which is expected to occur in fiscal 2016.

Equipment under Leases

Lease revenue is recognized as earned. The cost of the asset under lease is the original purchase price plus overhaul costs. Depreciation for aircraft is computed using the straight-line method over the estimated service life of the equipment. The balance sheet classification of equipment under lease is generally based on lease term, with fixed-term leases less than twelve months generally classified as short-term and all others generally classified as long-term.

Equipment on short-term lease includes aircraft engines and parts on or available for lease to satisfy customers' immediate short-term requirements. The leases are renewable with fixed terms, which generally vary from one to twelve months. In conjunction with our decision to exit certain product lines in our landing gear business, we recognized an impairment charge of \$17.7 million related to rotatable assets in fiscal 2015.

Table of Contents**AAR CORP. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Dollars in millions, except per share amounts)****1. Summary of Significant Accounting Policies (Continued)**

Equipment on long-term lease consists of engines on lease with commercial airlines generally for more than twelve months and rotatable parts used to support long-term supply chain programs. The rotatable parts included in equipment on long-term lease are being depreciated on a straight-line basis over their estimated useful lives. During the fourth quarter of fiscal 2015, we sold our two remaining wholly-owned aircraft which were on long-term leases for \$11.0 million which resulted in a loss on sale of \$14.8 million.

The following is a summary of equipment on or available for long-term lease:

	May 31,	
	2015	2014
Aircraft engines and rotatable parts	\$ 80.2	\$ 73.1
Aircraft		25.3
	\$ 80.2	\$ 98.4

Future rent due to us under non-cancelable leases during each of the next five fiscal years is \$18.4 million in 2016, \$17.6 million in 2017, \$17.2 million in 2018, \$16.7 million in 2019, and \$16.1 million in 2020.

Property, Plant and Equipment

We record property, plant and equipment at cost. Depreciation is computed on the straight-line method over useful lives of 10-40 years for buildings and improvements and 3-10 years for equipment, furniture and fixtures, and capitalized software. Aircraft, major components in service, and associated rotatable assets to support our expeditionary airlift services are depreciated over their estimated useful lives, which is generally 7-30 years. Leasehold improvements are amortized over the shorter of the estimated useful life or the term of the applicable lease.

Repair and maintenance expenditures are expensed as incurred. Upon sale or disposal, cost and accumulated depreciation are removed from the accounts, and related gains and losses are included in results of operations.

In accordance with ASC 360, *Property, Plant and Equipment*, we are required to test for impairment of long-lived assets whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable from its undiscounted cash flows. We utilize certain assumptions to estimate future undiscounted cash flows, including demand for our services, future market conditions and trends, business development pipeline of opportunities, current and future lease rates, lease terms, and residual values. Where a determination has been made to exit an entire asset group, the asset group is reviewed for potential impairment with an impairment loss recognized in the period in which it is determined that the aggregate carrying amount of assets within an asset group is not recoverable.

Capitalized Program Development Costs

Our Telair Cargo Group capitalized \$139.8 million, net of reimbursements, as of May 31, 2014 related to costs associated with the engineering and development of the A400M cargo system. The Telair Cargo Group was sold in March 2015 as further discussed in Note 2 Discontinued Operations. These capitalized costs are classified as current and non-current assets on the May 31, 2014 Consolidated Balance Sheet. At

Table of Contents

AAR CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollars in millions, except per share amounts)

1. Summary of Significant Accounting Policies (Continued)

May 31, 2014, current assets include \$27.6 million in Deposits, prepaids and other and non-current assets include \$112.2 million in Capitalized program development costs. The capitalized development costs were recovered upon the sale of the Telair Cargo Group.

Income Taxes

We are subject to income taxes in the U.S., state, and several foreign jurisdictions. In the ordinary course of business, there can be transactions and calculations where the ultimate tax determination is uncertain. We recognize deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns in accordance with applicable accounting guidance for accounting for income taxes, using currently enacted tax rates in effect for the year in which the differences are expected to reverse. We record a valuation allowance when necessary to reduce deferred tax assets to the amount expected to be realized.

The accounting for uncertainty in income taxes requires a more-likely-than-not threshold for financial statement recognition of tax positions taken or expected to be taken in a tax return. Where necessary, we record a liability for the difference between the benefit recognized for financial statement purposes and the tax position taken or expected to be taken on our tax return. To the extent that our assessment of such tax positions changes, the change in estimate is recorded in the period in which the determination is made.

Supplemental Information on Cash Flows

Supplemental information on cash flows is as follows:

	For the Year Ended May 31,		
	2015	2014	2013
Interest paid	\$ 42.7	\$ 33.8	\$ 28.3
Income taxes paid	105.6	17.3	24.1
Income tax refunds and interest received	12.1	7.5	23.2

On May 29, 2015, we repurchased 4,185,960 shares of our common stock at a price of \$31.90 per share pursuant to a tender offer utilizing \$133.5 million cash on hand. Fees and expenses of \$1.2 million were incurred related to the tender offer and were recorded in treasury stock. In addition to the tender offer, we also repurchased common shares of \$16.8 million and re-issued shares upon exercise of stock options, net of shares withheld to satisfy statutory tax obligations, of \$3.6 million during fiscal 2015.

During fiscal 2014, treasury stock decreased \$1.8 million reflecting the re-issuance of shares upon exercise of stock options, net of shares withheld to satisfy statutory tax obligations, and restricted stock award grants of \$2.8 million, partially offset by the purchase of treasury shares of \$1.0 million. During fiscal 2013, treasury stock increased \$9.7 million reflecting the purchase of treasury shares of \$14.6 million, partially offset by the re-issuance of shares upon exercise of stock options, net of shares withheld to satisfy statutory tax obligations, and restricted stock award grants of \$4.9 million.

Table of Contents

AAR CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollars in millions, except per share amounts)

1. Summary of Significant Accounting Policies (Continued)

Use of Estimates

We have made estimates and utilized certain assumptions relating to the reporting of assets and liabilities and the disclosures of contingent liabilities to prepare these Consolidated Financial Statements in conformity with accounting principles generally accepted in the United States. Actual results could differ from those estimates.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") 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 also supersedes 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, however the FASB issued a proposed ASU on April 29, 2015 which would defer the effective date of the new standard for one year. We are currently evaluating the impact of the adoption of this new standard on our consolidated financial statements.

In April 2014, the FASB issued ASU No. 2014-08, *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity* which requires that a disposal representing a strategic shift that has or will have a major effect on an entity's financial results or a business activity classified as held for sale should be reported as discontinued operations. The amendments also expand the disclosure requirements for discontinued operations and add new disclosures for individually significant dispositions that do not qualify as discontinued operations. The Company adopted this guidance on June 1, 2015 which will result in expanded disclosures related to the income statement and cash flow activities for our discontinued operations.

In April 2015, the FASB issued ASU No. 2015-03, *Simplifying the Presentation of Debt Issuance Costs*. This standard amends existing guidance to require the presentation of debt issuance costs in the balance sheet as a deduction from the carrying amount of the related debt liability instead of a deferred charge. This new standard will be effective for us beginning June 1, 2016 with early adoption permitted. We are currently evaluating the impact of the adoption of this new standard on our consolidated financial statements.

2. Discontinued Operations

On March 26, 2015, we completed the sale of our Telair Cargo Group to TransDigm, Inc. for \$725 million, subject to certain post-closing adjustments, including a working capital adjustment. The Telair Cargo Group was comprised of Telair International, Telair US, and Nordisk Aviation Products. Cash received at closing before fees and expenses was \$705 million with the remaining consideration of \$20 million placed in escrow and payable based on the occurrence of certain post-closing events related to the A400M cargo system. In addition, incremental contingent consideration of up to \$15 million related to the same cargo system development program could increase total proceeds to \$740 million. We recognized

Table of Contents

AAR CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollars in millions, except per share amounts)

2. Discontinued Operations (Continued)

a pre-tax gain on the sale (net of transaction expenses and fees) of \$198.6 million in the fourth quarter of fiscal 2015. The gain excludes the aggregate \$35 million of contingent consideration.

We have also announced our intention to sell our Precision Systems Manufacturing ("PSM") business comprised of our metal and composite machined and fabricated parts manufacturing operations. During fiscal 2015, we recognized impairment charges of \$57.5 million to reduce the carrying value of the PSM business's net assets to their expected value at the time of sale.

Telair Cargo Group and PSM, which were both previously reported in our Technology Products segment, are reported as discontinued operations in the Consolidated Statements of Operations for all periods presented. Interest expense allocated to discontinued operations was \$9.2 million, \$13.0 million and \$12.2 million for fiscal 2015, 2014, and 2013, respectively. No amounts for general corporate overhead were allocated to discontinued operations.

Sales for our discontinued operations were \$286.3 million, \$325.9 million, and \$329.4 million for fiscal 2015, 2014, and 2013, respectively. Liabilities of discontinued operations of \$5.4 million at May 31, 2015 were classified as *Accrued Liabilities* on the Consolidated Balance Sheet.

Unless otherwise noted, amounts and disclosures throughout these Notes to Consolidated Financial Statements relate to our continuing operations.

3. Financing Arrangements*Debt Outstanding*

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

	May 31,	
	2015	2014
Revolving Credit Facility expiring March 24, 2020 with interest payable monthly	\$ 50.0	\$ 130.0
Industrial revenue bond (secured by property, plant and equipment) due August 1, 2018 with interest payable monthly	25.0	25.0
Note payable due March 9, 2017 with floating interest rate, payable semi-annually on June 1 and December 1	20.0	30.0
Convertible notes payable due March 1, 2016 with interest at 2.25% payable semi-annually on March 1 and September 1	48.0	45.7
Notes payable originally due January 15, 2022 with interest at 7.25% payable semi-annually on January 15 and July 15		332.6
Other ¹	11.0	70.7
Total debt	154.0	634.0
Current maturities of debt	(69.0)	(69.7)
Long-term debt	\$ 85.0	\$ 564.3

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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,

Table of Contents

AAR CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollars in millions, except per share amounts)

3. Financing Arrangements (Continued)

and a secured credit facility originally due April 23, 2015 of \$0 million and \$29.9 million at May 31, 2015 and 2014, respectively.

The aggregate principal amount of debt maturing during each of the next five fiscal years is \$70.8 million in 2016, \$10.0 million in 2017, \$0 million in 2018, \$25.0 million in 2019, and \$50.0 million in 2020.

At May 31, 2015, the carrying value of our 2.25% convertible notes was \$48.0 million and the estimated fair value was approximately \$51.5 million. The 2.25% convertible notes 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.

At May 31, 2015, the remaining variable rate and fixed rate debt had a fair value that approximates the carrying value of \$106.0 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, 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.

Credit Facilities

On March 24, 2015, we entered into an amendment (the "Amendment") to our Revolving Credit Facility dated April 12, 2011, as amended, with various financial institutions, as lenders and Bank of America, N.A., as administrative agent for the lenders (the "Revolving Credit Facility").

The Amendment increased the aggregate revolving credit commitment from \$475 million to \$500 million. Under certain circumstances, the Company also could request an increase to the revolving commitment by an aggregate amount of up to \$250 million, not to exceed \$750 million in total.

Borrowings under the Revolving Credit Facility subsequent to the Amendment bear interest at the offered Eurodollar Rate plus 100 to 200 basis points based on certain financial measurements if a Eurodollar Rate loan, or at the offered fluctuating Base Rate plus 0 to 100 basis points based on certain financial measurements if a Base Rate loan.

The Amendment also extended the maturity of the Revolving Credit Facility by approximately two years to March 24, 2020; deleted the minimum fixed charge coverage ratio; and added a minimum interest coverage ratio. In addition to the interest coverage ratio, the Revolving Credit Facility requires us to comply with a leverage ratio and certain affirmative and negative covenants, including those relating to financial reporting and notification, payment of indebtedness, taxes and other obligations, compliance with applicable laws, and limitations on additional liens, indebtedness, acquisitions, investments and disposition of assets. The Revolving Credit Facility also requires our significant domestic subsidiaries, and any subsidiaries that guarantee our other indebtedness, to provide a guarantee of payment under the Revolving Credit Facility. At May 31, 2015, we were in compliance with the financial and other covenants in these agreements.

Table of Contents

AAR CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollars in millions, except per share amounts)

3. Financing Arrangements (Continued)

Borrowing activity under the Revolving Credit Facility during fiscal 2015, 2014 and 2013 is as follows:

	For the Year Ended May 31,		
	2015	2014	2013
Maximum amount borrowed	\$ 215.0	\$ 190.0	\$ 395.0
Average daily borrowings	140.7	135.8	312.3
Average interest rate during the year	1.69%	1.77%	2.03%

On March 28, 2013, we amended our secured credit facility with The Huntington National Bank (the "Huntington Loan Agreement"). The amendment to the Huntington Loan Agreement reduced our secured facility from \$65.0 million to \$40.0 million while also reducing the interest rate from 325 basis points to 175 basis points over LIBOR. Borrowings under the Huntington Loan Agreement were secured by aircraft and related engines and components owned by us. The Huntington Loan Agreement was repaid and terminated in the fourth quarter of fiscal 2015 using the sale proceeds from the Telair Cargo Group.

We also have \$2.7 million available under a foreign line of credit.

7.25% Senior Notes due 2022

On April 30, 2015, we redeemed our \$325 million 7.25% Senior Notes due 2022 for \$370.6 million. We recognized a loss on extinguishment of debt of \$44.9 million comprised of a make-whole premium of \$45.6 million and unamortized deferred financing costs of \$6.2 million, partially offset by an unamortized net premium of \$6.9 million.

Convertible Notes

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

	For the Year Ended May 31,		
	2015	2014	2013
Coupon interest	\$ 1.5	\$ 3.1	\$ 3.7
Amortization of deferred financing fees	0.1	0.3	0.5
Amortization of discount	2.4	5.1	9.3
Interest expense related to convertible notes	\$ 4.0	\$ 8.5	\$ 13.5

Table of Contents

AAR CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollars in millions, except per share amounts)

4. Derivative Instruments and Hedging Activities

We are exposed to interest rate risk associated with fluctuations in interest rates on our variable rate debt. Prior to the fourth quarter of fiscal 2015, we utilized two derivative financial instruments to manage our variable interest rate exposure. We utilized a floating-to-fixed interest rate swap and an interest rate cap agreement with each hedging \$50.0 million of notional principal interest under our Revolving Credit Facility. In connection with the Amendment of our Revolving Credit Facility, we settled our floating-to-fixed interest rate swap and interest rate cap agreements in the fourth quarter of fiscal 2015 for approximately \$2.6 million.

Prior to the settlement, the derivatives instruments were classified as cash flow hedges with gains and losses on the derivative instruments included in other comprehensive income. We recognized gains and losses on our derivative instruments as an adjustment to interest expense in the period the hedged interest payment affected earnings. We recognized a loss of \$2.0 million in fiscal 2015 related to the reclassification of previously unrealized losses in accumulated other comprehensive income. The impact of the interest rate swap and interest cap agreement on the Consolidated Statement of Comprehensive Income for the years ended May 31, 2014 and 2013 was unrealized gains of \$0.7 million and \$0.6 million, respectively. At May 31, 2014, the fair value of our floating-to-fixed interest rate swap was a liability of \$2.8 million and the fair value of our interest rate cap agreement was an asset of \$0.1 million.

5. Stock-Based Compensation

We provide stock-based awards under the AAR CORP. Stock Benefit Plan ("Stock Benefit Plan") and the AAR CORP. 2013 Stock Plan (the "2013 Stock Plan"), each of which has been approved by our stockholders. Under the Stock Benefit Plan and the 2013 Stock Plan, we are authorized to issue stock options to employees and non-employee directors that allow the grant recipients to purchase shares of common stock at a price not less than the fair market value of the common stock on the date of grant. Generally, stock options awarded expire ten years from the date of grant and are exercisable in three, four or five equal annual increments commencing one year after the date of grant. In addition to stock options, the Stock Benefit Plan and the 2013 Stock Plan also provide for the grant of restricted stock awards and performance-based restricted stock awards. The number of performance-based awards earned, subject to vesting, is based on achievement of certain Company-wide financial goals or stock price targets. The Stock Benefit Plan and the 2013 Stock Plan also provide for the grant of stock appreciation units and restricted stock units; however, to date, no such awards have been granted.

Restricted stock grants are designed, among other things, to align employee interests with the interests of stockholders and to encourage the recipient to build a career with us. Restricted stock typically vests over periods of one to five years from date of grant. Restricted stock grants may be performance-based with vesting to occur over periods of three to six years. All restricted stock that has been granted and earned according to performance criteria carries full dividend and voting rights, regardless of whether it has vested.

Substantially all stock options and restricted stock are subject to forfeiture prior to vesting if the employee's employment terminates for any reason other than death, disability or retirement. Since inception, a total of 11,149,000 shares have been granted under the Stock Benefit Plan. With the stockholder approval of the 2013 Stock Plan, we granted a total of 331,000 shares in fiscal 2015 under the 2013 Stock Plan and plan to make all future stock awards under the 2013 Stock Plan rather than the Stock Benefit Plan. There are 2,180,000 shares available for grant under the 2013 Stock Plan as of May 31, 2015.

Table of Contents

AAR CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollars in millions, except per share amounts)

5. Stock-Based Compensation (Continued)

Stock Options

No stock options were granted during fiscal 2015. During fiscal 2014 and 2013, we granted stock options representing 1,033,015 shares and 972,180 shares, respectively. The weighted average fair value per share of stock options granted during fiscal 2014 and 2013 was \$10.24 and \$4.85, respectively. The fair value of each stock option grant was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	Stock Options Granted In Fiscal Year	
	2014	2013
Risk-free interest rate	1.4%	0.6%
Expected volatility of common stock	49.1%	51.4%
Dividend yield	1.2%	2.3%
Expected option term in years	5.2	5.4

The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant. The expected volatility is based on historical volatility of our common stock, and the expected option term represents the period of time that the stock options granted are expected to be outstanding based on historical exercise trends. The dividend yield represents our anticipated cash dividends at the grant date over the expected option term.

A summary of stock option activity for the three years ended May 31, 2015 consisted of the following (shares in thousands):

	2015		2014		2013	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	2,753	\$ 19.59	2,300	\$ 16.22	1,703	\$ 17.96
Granted		\$	1,033	\$ 25.43	972	\$ 12.95
Exercised	(793)	\$ 15.98	(473)	\$ 16.20	(124)	\$ 13.72
Cancelled	(103)	\$ 21.03	(107)	\$ 18.48	(251)	\$ 15.82
Outstanding at end of year	1,857	\$ 21.05	2,753	\$ 19.59	2,300	\$ 16.22
Options exercisable at end of year	627	\$ 21.78	1,019	\$ 17.88	1,089	\$ 17.73

The total fair value of stock options that vested during fiscal 2015, 2014, and 2013 was \$3.1 million, \$2.0 million, and \$3.6 million, respectively. The total intrinsic value of stock options exercised during fiscal 2015, 2014, and 2013 was \$11.1 million, \$4.3 million, and \$0.5 million, respectively. The aggregate intrinsic value of options outstanding was \$16.0 million and \$15.2 million as of May 31, 2015 and 2014, respectively. The tax benefit realized from stock options exercised during fiscal 2015, 2014, and 2013 was \$2.4 million, \$1.0 million, and zero, respectively. Expense charged to operations for stock options during fiscal 2015, 2014, and 2013 was \$2.9 million, \$3.8 million, and \$3.5 million, respectively, recorded in selling, general

Table of Contents

AAR CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollars in millions, except per share amounts)

5. Stock-Based Compensation (Continued)

and administrative expenses. As of May 31, 2015, we had \$6.7 million of unrecognized compensation expense related to stock options that will be amortized over an average period of 1.4 years.

The following table provides additional information regarding stock options outstanding as of May 31, 2015 (shares in thousands):

Option Exercise Price Range	Number Outstanding as of 5/31/15	Options Outstanding Weighted-Average Remaining Contractual Life in Years	Weighted-Average Exercise Price	Options Exercisable Number as of 5/31/15	Weighted-Average Exercise Price
\$10.00 - \$15.00	564	7.1	\$ 12.90	94	\$ 12.90
\$15.01 - \$20.00	226	4.7	\$ 16.79	220	\$ 16.81
\$20.01 - \$34.50	1,067	7.5	\$ 26.26	313	\$ 27.94
	1,857	7.1	\$ 21.05	627	\$ 21.78

Restricted Stock

We provide executives and other key employees an opportunity to be awarded performance-based and time-based restricted stock. The performance-based awards are contingent upon the achievement of certain performance objectives, including net income and return on capital. During fiscal 2015, 2014, and 2013, we granted 188,125, 60,808, and 53,280 of performance-based restricted shares, respectively. Time-based restricted shares of 97,581, 60,808, and 65,780 were granted to executives and key employees during fiscal 2015, 2014, and 2013, respectively. We also award time-based restricted stock to our non-employee directors as part of their annual compensation. Time-based restricted shares of 45,000, 45,000, and 48,333 were granted to members of the Board of Directors during fiscal 2015, 2014, and 2013, respectively.

The fair value of restricted shares is the market value of our common stock on the date of grant. Expense related to all restricted share programs during fiscal 2015, 2014, and 2013 was \$4.9 million, \$4.9 million, and \$7.6 million, respectively, and recorded in selling, general and administrative expenses.

Restricted share activity during the fiscal year ended May 31, 2015 was as follows (shares in thousands):

	Number of Shares	Weighted Average Fair Value on Grant Date
Nonvested at May 31, 2014	990	\$ 22.49
Granted	331	\$ 25.86
Vested	(178)	\$ 19.20
Forfeited	(89)	\$ 20.21
Nonvested at May 31, 2015	1,054	\$ 24.38

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As of May 31, 2015, we had \$8.5 million of unearned compensation related to restricted shares that will be amortized to expense over a weighted average period of 1.3 years.

Table of Contents**AAR CORP. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Dollars in millions, except per share amounts)****5. Stock-Based Compensation (Continued)***Shareholders' Rights Plan*

Pursuant to a shareholder rights plan adopted in 2007, each outstanding share of our common stock carries with it a Right to purchase one share at a price of \$140 per share. The Rights become exercisable (and separate from the shares) when certain specified events occur, including the acquisition of 15% or more of the common stock by a person or group (an "Acquiring Person") or the commencement of a tender or exchange offer for 15% or more of the common stock.

In the event that an Acquiring Person acquires 15% or more of the common stock, or if we are the surviving corporation in a merger involving an Acquiring Person or if the Acquiring Person engages in certain types of self-dealing transactions, each Right entitles the holder to purchase for \$140 per share (or the then-current exercise price), shares of our common stock having a market value of \$280 (or two times the exercise price), subject to certain exceptions. Similarly, if we are acquired in a merger or other business combination or 50% or more of our assets or earning power is sold, each Right entitles the holder to purchase at the then-current exercise price that number of shares of common stock of the surviving corporation having a market value of two times the exercise price. The Rights do not entitle the holder thereof to vote or to receive dividends. The Rights will expire on August 6, 2017, and may be redeemed by us for \$.01 per Right under certain circumstances.

6. Income Taxes

The provision for income tax (benefit) on income from continuing operations includes the following components:

	For the Year Ended May 31,		
	2015	2014	2013
Current:			
Federal	\$ 22.2	\$ 11.4	\$ (3.7)
State	0.4	0.4	(0.7)
Foreign	1.5	0.8	1.5
	24.1	12.6	(2.9)
Deferred	(52.6)	19.0	28.3
	\$ (28.5)	\$ 31.6	\$ 25.4

Table of Contents

AAR CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollars in millions, except per share amounts)

6. Income Taxes (Continued)

The provision for income taxes on income from continuing operations differs from the amount computed by applying the U.S. federal statutory income tax rate of 35% for fiscal 2015, 2014, and 2013 to income before taxes (benefit), due to the following:

	For the Year Ended May 31,		
	2015	2014	2013
Provision for income tax (benefit) at the federal statutory rate	\$ (29.0)	\$ 34.6	\$ 26.0
State income taxes, net of federal benefit and refunds	0.2	0.2	0.4
Federal adjustments	0.5	(2.0)	0.3
Domestic Production Activities Deduction	(0.2)	(1.2)	
State adjustments			(1.3)
Provision for income tax (benefit)	\$ (28.5)	\$ 31.6	\$ 25.4

Income (Loss) before provision for income tax (benefit) includes the following components:

	For the Year Ended May 31,		
	2015	2014	2013
Domestic	\$ (94.2)	\$ 81.9	\$ 58.4
Foreign	11.2	16.9	15.8
	\$ (83.0)	\$ 98.8	\$ 74.2

Deferred tax liabilities and assets result primarily from the differences in the timing of the recognition of transactions for financial reporting and income tax purposes. During the fourth quarter of fiscal 2015, we identified certain classification errors within our deferred tax asset and liability accounts as of May 31, 2014. These errors did not impact the net deferred tax liability at May 31, 2014 of \$132.1 million. We have revised the components of our deferred tax assets and liabilities in the following table and our Consolidated Balance Sheet as of May 31, 2014 to reflect a decrease of \$5.5 million in both *Deferred tax assets - current* and *Deferred tax liabilities - noncurrent*. We have concluded these errors were not material to any prior reporting periods.

Table of Contents

AAR CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollars in millions, except per share amounts)

6. Income Taxes (Continued)

Our deferred tax liabilities and assets consist of the following components:

	May 31,	
	2015	2014
Deferred tax assets-current attributable to:		
Inventory costs	\$ 35.4	\$ 14.4
Impairment of PSM assets	13.4	
Advanced billings	6.0	2.0
Employee benefits	3.5	7.9
Other		0.3
Total net deferred tax assets-current	58.3	24.6
Deferred tax assets-noncurrent attributable to:		
Postretirement benefits	18.9	17.6
Advanced billings	8.3	16.2
Foreign intangible assets		44.2
Other	3.9	6.7
Total deferred tax assets-noncurrent	31.1	84.7
Total deferred tax assets	89.4	109.3
Valuation allowance	(2.8)	(2.8)
Total deferred tax assets net of valuation allowance	\$ 86.6	\$ 106.5