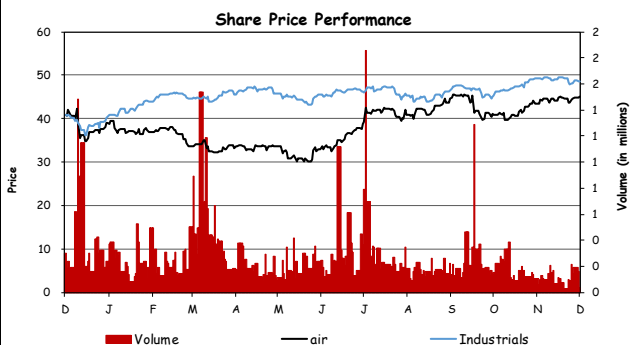


AAR Corp.	Symbol: air
Analyst	Phillip Harabarovici
Buy below	\$39.82
Sell above	\$53.43
Probability of Price Increase	60%
Last Price	\$45.00
Intrinsic Value	\$44.53
Target Dividends	\$0.00
Target Price	\$47.78



Description
AAR Corp. provides products and services to commercial aviation, government, and defense markets worldwide.

Sector Industrials
Industry Aerospace and Defense
Last Guidance December 11, 2018
Next earnings date December 19, 2019

People
Holmes, John, CEO, President & Director
Gillen, Sean, VP & CFO
Pachapa, Eric, VP, Controller & Chief Accounting Officer
Regan, Robert, VP, General Counsel & Secretary
Stinson, Terry, Executive Vice President
Jessup, Christopher, Chief Commercial Officer & VP

Top Competitors

--	Moog Inc.
--	--
Aerojet Rocketdyne Holdings, Inc.	Vectrus, Inc.
Triumph Group, Inc.	--
Cubic Corporation	--

Market Statistics

Market Capitalization (mil)	\$1,546.28
Last Price per share	\$45.00
52 week high	\$47.62
52-week low	\$29.84
Volatility	30.55%
Daily volume (mil)	0.04
Short interest	3.50%
Days to cover short interest	6.31
Beta	1.32

Financials

	air (LTM)	air Historical	Peers' Median (LTM)
Profitability			
Return on Capital	6.9%	6.26%	5.84%
Adjusted EBITDA Margin	7.1%	5.49%	7.15%
Return on Equity	-1.0%	6.2%	10.0%
Adjusted Net margin	-0.4%	3.2%	4.5%
Invested Funds			
Cash/Capital	3.0%	1.9%	5.1%
NWC/Capital	51.4%	32.7%	19.6%
Operating Assets/Capital	35.5%	57.0%	38.8%
Goodwill/Capital	10.0%	10.6%	34.2%
Capital Structure			
Total Debt/(Market Cap.+ Other Claims on Capital)	0.21	0.21	0.20
Minority Interest/(Market Cap.+ Other Claims on Capital)	0.0%	0.0%	0.0%
Preferred Equity/(Market Cap.+ Other Claims on Capital)	0.0%	0.0%	0.0%
CGFS Credit Rating	BB		CC
Credit Rating Model	bbb-		bb to bb+
Probability of Default Model	bbb to bbb+		bb to bb+
Likely Current Cost of Debt	4.70%		4.56%
Likely Current Cost of Equity (Cost of Debt + MRP)	10.52%		10.39%
Likely Current WACC	9.31%		9.2%

Investment Thesis

Increasing Services and Efficiencies in Aviation

I am initiating coverage of AAR Corp with a LIMIT BUY at \$39.82 and a \$47.78 price target. AAR is a diversified provider of products and services to the worldwide aviation and government and defense markets. I view AIR as a company that continues to leverage their current contracts by introducing efficiencies in production and servicing. As well as continuing the majority standard commercial purchase orders. Their steady acquisition of contracts and reduction of low-margin businesses also provides a value opportunity.

For the long:

1. Continuing pushing for growth in military contracts

Focusing on growth and execution of programs with customer relationships in international commercial and government customers. The company completed a ramp - up of 15 years, U.S. Air Force Landing Gear Performance-Based Logistics One program, providing total supply chain management. Including purchasing, distribution, and inventory control for all landing gear components for the Air Force. As well as a ramp - up of a contract with the Department of State leveraging capabilities in service for a 10-year performance-based contract to globally operate and maintain aircraft.

2. Growth Profit Margin increasing in key segments:

Driven by the Department of State contract the (INL/A WASS program) the gross profit on government and defense customers increased 64.9% of the fiscal 2019. The gross profit margin increased to 20.4% from 20.2% from fiscal 2019 to fiscal 2018. With the largest sensitivity highlighted below on Enterprise Value to EBITDA of 52.88% this is a positive as long as the company can increase margins as the continue to push revenue growth. I believe this is a continuing trend in the company.

3. Flexibility in Balance Sheet to invest in Growth

Cash on hand and available credit facility increased to \$465 million. The company is in a great financial position compared to some of its peers. Their debt levels remain in check with fluctuations occurring due to their contractual needs with customers.

For the short:

1. Unability to reduce carrying value of assets

The company owns and distributes assets that may not be useful to the company in the future. The company has recorded these assets as non-recoverable and incurred impairment charges to reduce the carry value. In fiscal 2019 the impairment was \$74.1 million and in 2018 \$54.2. With the discontinuation of "COCO" (Contractor owned, contractor operated business) the inability to sell these assets and contracts may also increase the carry value of these useless assets.

2. Increasing cost in Aviation Services commercial segment:

Their largest segment, Aviation services, consists of 95% of their gross profit. Commercial gross profit consists of 62% of this segment. Last year the company saw a reduction in margin for this segment because of labor shortages. This caused an inability to meet demand from customers. A continuation of this trend would prove detrimental to the price.

Key Catalysts for price change

- Increasing high-margin contracts with governments
- Increasing efficiencies in Aviation Services segment
- Continuing to discontinue low-earning pieces of business

Valuation

My \$47.78 price target is derived from Discounted Unlevered Free Cash Flow estimates with a weight of 50% as well as a triangulated EV/EBITDA multiple of 10.9x.

Ownership

	Change in Ownership (over the past 6 months)
Shares outstanding (mil)	34.44
Weighted Diluted shares outstanding (mil)	34.53
Options and Warrants (Shares equivalent)	0.55
% shares held by institutions	96%
% shares held by investments Managers	85%
% shares held by hedge funds	4.39%
% shares held by VC/PE firms	0.496%
% shares held by insiders	5.73%
Poison Pill and Type	Yes: Flip-Over Combined With Flip-In

Quarterly Earning Surprises (Actual/Median Estimates)

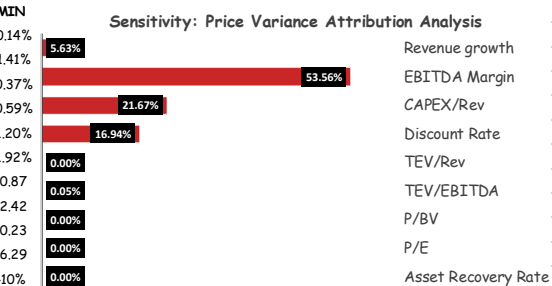
Revenue	Last 5 quarters
8/31/2018	\$1865.2 (2.5%)
11/30/2018	\$1973.2 (-0.5%)
2/28/2019	\$2118 (-1.2%)
5/31/2019	\$2250.8 (6.1%)
8/31/2019	\$2166 (11%)
History:	Last 10 years
Mean Surprise	-1.79%
99th percentile "surprise" range	-25% to 21%
EBITDA	Last 5 quarters
8/31/2018	\$130 (-18.9%)
11/30/2018	\$110 (-34.8%)
2/28/2019	\$162.4 (-16.5%)
5/31/2019	\$167.2 (-8.6%)
8/31/2019	\$137.6 (-9.6%)
History:	Last 10 years
Mean Surprise	-21.40%
99th percentile "surprise" range	-80% to 37%

AAR Corp.	Symbol: air
Analyst	Phillip Harabarovici
Buy below	\$41.18
Sell above	\$50.72
Probability of Price Increase	60%
Last Price	\$44.93
Intrinsic Value	\$44.11
Target Dividends	\$0.00
Target Price	\$47.36

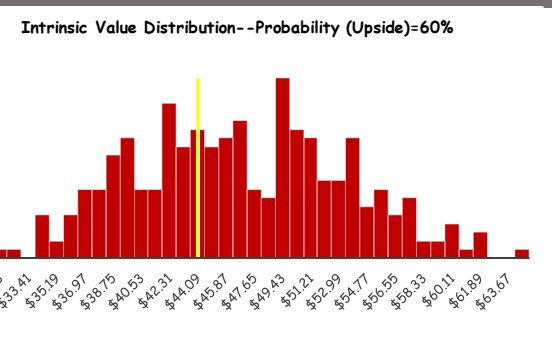
Cost of Capital Estimates			
	CGFS Credit Rating	Credit Rating Model	Probability of Default Model
Implied Cost of Borrowing (air)	4.4%	4.8%	4.4%
Implied Cost of Borrowing (Peers)	5.7%	5.3%	5.4%
	Base Year	Explicit Period (15 years)	Continuing Period
Cost of New Debt Estimate	3.85%	4.43%	4.43%
Country Risk Premium Estimate	5.82%	5.82%	5.82%
Cost of Equity Estimate	9.68%	10.26%	10.26%
WACC Estimate	8.62%	9.17%	9.17%

Forecast Assumptions						
Fiscal Year	Revenue Growth	EBITDA Margin	CAPEX/Revenue	DPR/CAPEX	Other	
Base Year (Actual)	10.50%	7.8%	0.8%	2.46	SBC/Revenue	0.65%
year 1	7.61%	7.8%	0.8%	0.89		Constant/same as LTM
year 2	4.85%	8.7%	0.8%	0.90	Lease term	10
year 3	3.73%	8.6%	0.7%	0.90	Rent Expense/Revenue	1.52%
year 4	3.64%	8.6%	0.8%	0.91		Tappers off to historical average
year 5	3.54%	8.5%	0.8%	0.92	R&D life	10
year 6	3.45%	8.5%	0.9%	0.93	R&D Expense/Revenue	0.00%
year 7	3.35%	8.4%	0.9%	0.93		Constant/same as LTM
year 8	3.26%	8.3%	0.9%	0.94	LIFO Reserve	Tappers off to zero
year 9	3.16%	8.3%	1.0%	0.95	Non-operating pension costs	Tappers off to zero
year 10	3.07%	8.2%	1.0%	0.96	Net financing pensions costs	Tappers off to zero
year 11	2.97%	8.1%	1.1%	0.96	Overfunded pension plans	Tappers off to zero
year 12	2.88%	8.1%	1.1%	0.97	Capitalized interests	Constant/same as LTM
year 13	2.78%	8.0%	1.2%	0.98	Dividends/Revenue	0.25%
year 14	2.69%	8.0%	1.2%	0.99	Tax Rate	24.00%
year 15	2.59%	7.8%	1.3%	0.99		
Continuing Period	2.50%	7.8%	1%	1.00		

Simulation Assumptions			
Random Variables	Distribution Assumption	MAX	MIN
Deviations in annual Revenue Growth--Expl. Per.	Triangular	1.05%	-0.14%
Deviations in annual Revenue Growth --Cont. Per.	Normal	1.41%	-1.41%
Deviations from EBITDA Margin base annual estimates	Triangular	0.31%	-0.37%
Deviations from CAPEX/Revenue base annual estimates	Triangular	1.04%	-0.59%
Deviations from Kd base annual estimates	Triangular	0.99%	-1.20%
Deviations from CRP base annual estimates	Triangular	1.82%	-1.92%
Deviations from TEV/Revenue base estimate	Triangular	0.44	-0.87
Deviations from TEV/Revenue base estimate	Triangular	2.36	-2.42
Change in P/BV (TTM)	Triangular	3.68	-0.23
Change in P/E (FW)	Triangular	8.85	-6.29
Recovery Rate	Triangular	10.00%	0%



Valuation			
DCF Valuation	Base	Explicit Period (Average)	Continuing Period
Revenues	\$2,127.00	\$2,898.05	\$3,686.66
EBITDA Margin	7%	8%	8%
UFCF	\$104.50	\$124.74	\$290.02
WACC	8.62%	9.17%	9.17%
ROIC	6.94%	9.68%	9.17%
Relative Valuation			
	Median Justified Multiple	Basis	Implied Equity Value
EV/Rev (FW)	1.3x	\$2,325.85	\$2,448.76
Triangulated EV/EBITDA (FW)	10.9x	\$187.06	\$1,525.77
P/BV (TTM)	2.3x	\$911.40	\$2,091.60
P/E (FW)	15.9x	\$44.79	\$714.11



Asset Based Valuation	
Recovery Rate	60%
Capital	\$2,022.72
Intangibles	\$128.80
Claims	\$497.77
Implied Equity Value	\$638.58

Valuation Summary			
	Intrinsic Value	Target Price	Model Weight
DCF Valuation	\$ 47.06	\$ 49.81	50%
EV/Rev (FW)	\$ 69.82	\$ 75.83	0%
EV/EBITDA (FW)	\$ 43.50	\$ 47.25	50%
P/BV (TTM)	\$ 59.64	\$ 64.77	0%
P/E (FW)	\$ 20.36	\$ 22.12	0%
Asset Based Valuation	\$ 18.21	\$ 19.78	0%
Price per Share	\$ 45.28	\$ 48.53	100%