March, 3, 2016

Company Name:

AAR Corporation (NYSE AIR)

Marion HORRY

Sector: Industrial Goods

Industry: Aerospace/ Defense Products and services

AAR Corporation has it's headquarter located in Chicago. The company is operating in two segments: aviation services and expeditionary Services. The aviation service offered by the company is based on retailing parts, maintaining and repairs of component and supply chain development. This segment has been develop in order to provide aircraft availability, to increase efficiency and decrease the costs. The second segment, expeditionary service ensure movement of equipment and employee. They can ensure this service by specialized product and services such as airlift services and pallets, containers and shelters.

BUY

Current Price:	$33.81
Target Price:	$55.16
Market Cap:	1.16B
Beta:	1.49

Thesis:

For the next following year AAR corporation will ensure revenue growth with a large number of contract signed with different type of industries and organizations.
At the same time, the company will be able to reduce the cost to meet government demand. This will ensure growing margin and profitability.
Revenue increasing and profitability increasing will increase the EBIT and the free cash flow.
Having a large amount of free cash is showing that the company is creating value. This value creation should be reflected in the stock price.
I advise to buy AAR Corp. because it stock price is currently undervalued.
I expect the price of this stock to rise in the future between $48.55 and $55.16

Catalysts:

- **Short Term(within the year):**
  The next earning is on March21, 2017. This can increase the volatility of the stock and help to reach the target price.
- **Mid Term(1-2 years):**
  Trump position on increasing military expenses.
- **Long Term(3+):**
  New contracts with :
  - Department of State INL/A
  - Navy C40A
  - Afghan C-130
  - RSAF
  - Some airline companies

  This contract are from 3 to 10 years contract. This will ensure long term revenue growth.

High Standard products and services:

The AAR corporation works on different products and services and in order to stay competitive on the market they are relying on innovation in order to reduce cost of production and to have a high quality products.
Their major products are fairing, inferior structures, complete aircraft interiors, fully integrated assemblies, flight simulator structures, flat panel products.
Moreover, this company have created different service that can be adapted to the different customers. This service are there to ensure the quality of the products such as reducing weight of products, to optimize the product to the need of the customers.
In order to create a competitive advantage from their services they are following this different stage:

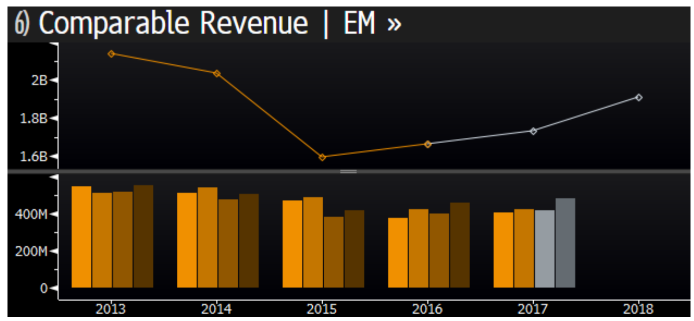
Process of product optimization:

1- Design control process: during this stage, the company employee are planning, compliance management and design review;
2- Composite and Assembly Design: during this stage the company is defining the model and dealing with digital mookup management.
3- Stress Analysis: during this stage the company is loading the development, sizing and optimizing components
4- Product testing and validation: during this stage the company is testing and validating the product
5- CNC machining: during this stage the company is producing the prototype.

New Contracts signed:

The company launch new programs and signed new long terms contracts with INL/A, the Navy, Afghan C-130, RSAF C-130, some airline companies such as air Canada, Alaska, air nostrum, skywest. The new contracts obtained should led to 9.450 billion increase in sales revenue. This revenue will be reported during the following period of 3 years to 10 years. The corporation will be able to ensure per year a growth of 5% to 10% for this period. The increase in revenue will be notice during the period because AAR corporation is using percentage completion method. The revenue growth will ensure a growing EBIT. If EBIT is increasing the free cash flow will increase as well. Thus, the stock price will react to this change in revenue and it will increase the price.

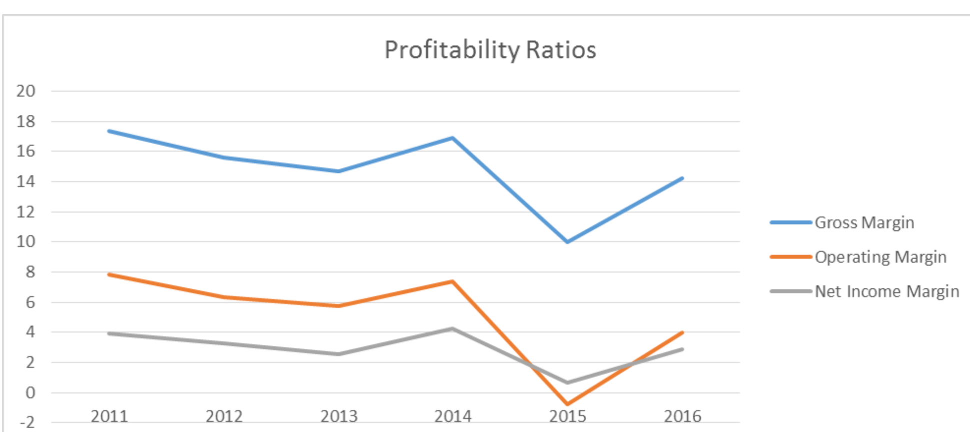
The company is also focusing on government opportunity. They will create unique solution for trump administration to ensure lower cost. By offering lower cost, AAR corporation will be able to meet government expectation. Actually, they signed a contract with United States transportation Command. This contract is valued at $204.2 million. AAR corporation will offer aviation services to the USTRANSCOM.



Margin Performance:

The margin performance of the company are increasing after the bad year of 2015. It is important to notice that the expeditionary segment is generating more profitability than the other segment. Through the time, AAR has been able to generate a large amount of income after paying their cost. The company struggled in 2015 because of one of their program. The program was not profitable and the company had to recover its losses in 2015. Since 2016 the company is following an upward trends on revenue and in profitability ratio.

The gross margin ratio shows that the company will be able to ensure future profitability and more precisely a growing profitability. It is possible to argue this because they are able to cut cost to ensure new opportunities with the government. The company is putting effort in increasing margin to ensure increase in EBIT. The upward trend of the EBIT will generate higher free cash flow and it will increase the stock price of the company.
Moreover by looking at the operating margin, it is possible to observe the same trend as the gross margin.
In addition, the net income margin emphasize the same trends. It is important to notice that the company will through the following period ensure higher profitability.



Unlevered Company

AAR corporation has a debt to equity ratio of 18.47%. This percentage of debt compare to competitors is low. The company is financing more assets with equity than with debt. The total debt to assets ratio also shows that this company is an unlevered company. Thus, this company is unlevered and has a low financial risk compare to its competitors.

Their capital structure shows that they can take advantage of new opportunities that will arise in the future.

Ticker ↑	Debt/Equity LF	Debt/Assets LF
	31.69%	22.39%
AIR US	18.47%	10.84%
WAIR US	95.09%	43.21%
TGI US	169.08%	34.13%
TASR US	0.04%	0.02%
SNR LN	46.81%	23.26%
EGL US	155.34%	48.41%
CUB US	66.42%	30.40%

Free Cash Flow

The graph of the free cash flow shows that in 2015 and 2016, the company was not able to generate cash. It is true that having a negative free cash flow shows that the company is not able to generate cash from investment.

The decrease in free cash flow experience by the company is mainly due by a large decrease in assets in 2015. In 2016, the company starts again to invest in assets and then it will positively affect the free cash flow.

In the following period, the company should be able to generate more and positive free cash flow.

The free cash flow will be driven up by an increase in revenue and an increase in margins.

Ownership

Top Ownership Type (%)			
54) Ownership Type	02/26/17	Curr	Change
41) Investment Advisor	84.62	82.95	-1.67
42) Individual	5.95	6.67	+0.72
43) Hedge Fund Manager	5.68	6.36	+0.68
44) Pension Fund	1.47	1.64	+0.17
45) Insurance Company	0.72	0.79	+0.07
46) Sovereign Wealth Fund	0.64	0.55	-0.09
47) Bank	0.39	0.44	+0.05
48) Government	0.20	0.23	+0.03
49) Brokerage	0.20	0.22	+0.02

This table shows the owners of the AAR corporation. The major type of owners are investment advisors at 82.95% following by individuals at 6.67%. Hedge fund only represents 6.36% of the owners of the company. The hedge fun ownership increased by 0.68%. It is a sign of the hedge fund interest on the company. Moreover, it emphasizes possible value creation of the company.

Conclusion:

In conclusion, it is important to notice that AAR Corporation has and will continue to gain more competitive advantage because they will follow their increase in growth revenue. This growth will ensure the financial stability since the company has a good cost control strategy. Moreover, the company is able to capture new opportunity because they have a low percentage of debt compare the industry. And finally, the manager are taking into consideration the impact of new technology and they are keeping implementing new technologic equipment that will ensure an efficient production and competitive advantage.

SIENA college

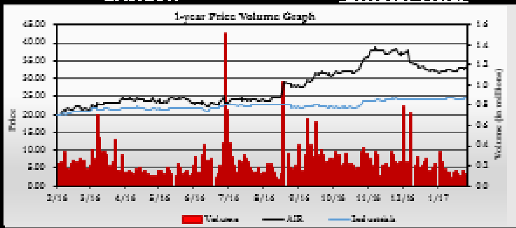
BJORKLUND FUND

AAR Corp. (AIR)

CENTER FOR GLOBAL FINANCIAL STUDIES

BULLISH

Analysis by Marion HOBBY	Current Price:	$33.81	Intrinsic Value	$48.55	Target 1 year Return: 64.08%
2/15/2017	Divident Yield:	0.9%	Target Price	$55.16	Probability of Price Increase: 10



Description

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

General Information

Sector	Industrials
Industry	Aerospace and Defense
Last Guidance	November 3, 2015
Next earnings date	March 21, 2017
Estimated Country Risk Premium	7.45%
Effective Tax rate	36%
Effective Operating Tax rate	41%

Market Data

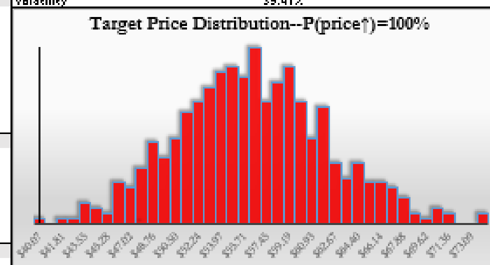
Market Capitalization	$1,163.79
Daily volume (mil)	0.01
Shares outstanding (mil)	34.33
Diluted shares outstanding (mil)	34.25
% shares held by institutions	18%
% shares held by investments Managers	83%
% shares held by hedge funds	4%
% shares held by insiders	7.12%
Short interest	2.08%
Days to cover short interest	3.35
52 week high	$38.75
52-week low	$19.41
Levered Beta	1.58
Volatility	35.47%

Past Earning Surprises

Quarter ending	Revenue	EBITDA
11/30/2015	5.40%	-22.55%
2/29/2016	-2.99%	-23.97%
5/31/2016	-4.50%	-18.25%
8/31/2016	1.20%	-10.51%
11/30/2016	-5.53%	-23.56%
Mean	-1.28%	-19.77%
Standard error	2.0%	2.5%

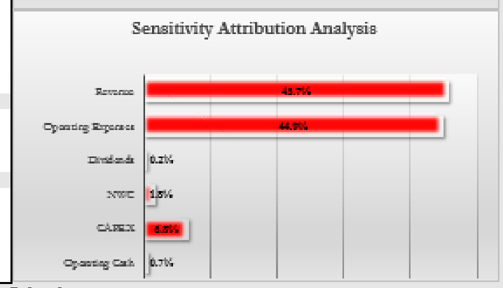
Peers

Esterline Technologies Corporation
Moog Inc.
TransDigm Group Incorporated
Woodward, Inc.
B/E Aerospace, Inc.
Triumph Group, Inc.
Cubic Corporation
Hexcel Corporation

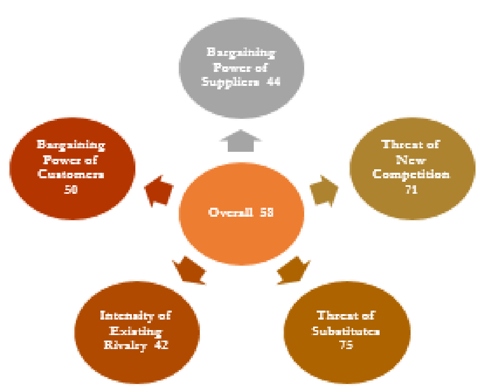


Management	Position	Total compensation growth	Total return to shareholders
Storch, David	Chairman, Chief Executive Of	-1.98% per annum over 6y	-10.1% per annum over 6y
Romenesko, Timothy	Vice Chairman and Chief Fina	-3.71% per annum over 6y	-10.1% per annum over 6y
Regan, Robert	Vice President, General Coun	-1.18% per annum over 6y	-10.1% per annum over 6y
Holmes, John	Chief Operating Officer of A	23.54% per annum over 2y	12.89% per annum over 2y
Eichner, Ira	Founder and Chairman Emeritu	N/M	N/M
Pachapa, Eric	Chief Accounting Officer, Vi	N/M	N/M

Profitability	AIR (LTM)	AIR (5 years historical av	Industry (LTM)
ROIC	7.6%	4.13%	14.48%
NOPAT Margin	4%	2.62%	9.7%
Revenue/Invested Capital	2.09	1.57	1.50
ROE	6.9%	5.32%	17.89%
Adjusted net margin	3%	1.57%	8.6%
Revenue/Adjusted Book Value	2.16	3.39	2.08
Invested Funds	**AIR (LTM)**	**AIR (5 years historical av**	**Industry (LTM)**
Total Cash/Total Capital	4.3%	5.7%	20%
Estimated Operating Cash/Total Capital	1.9%	3.1%	N/A
Non-cash working Capital/Total Capital	32.2%	28.4%	12%
Invested Capital/Total Capital	65.1%	64.0%	86%
Capital Structure	**AIR (LTM)**	**AIR (5 years historical av**	**Industry (LTM)**
Total Debt/Common Equity (LTM)	0.22	0.59	0.28
Cost of Existing Debt	4.18%	3.86%	3.59%
Estimated Cost of new Borrowing	4.18%	3.52%	3.59%
CGFS Risk Rating	CC	CCC	CC
Unlevered Beta (LTM)	1.32	1.13	0.77
WACC	12.73%	9.72%	9.19%



Porter's 5 forces (scores are out of 100)



Valuation

Period	Revenue growth	NOPAT margin	ROIC/WACC
Base Year	3.6%	3.6%	0.60
11/30/2017	4.1%	4.9%	0.83
11/30/2018	6.7%	5.8%	0.95
11/30/2019	9.7%	6.1%	1.03
11/30/2020	9.0%	7.0%	1.17
11/30/2021	8.3%	7.7%	1.29
11/30/2022	7.6%	8.6%	1.42
11/30/2023	6.9%	9.4%	1.55
11/30/2024	6.2%	10.2%	1.67
11/30/2025	5.5%	11.0%	1.79
11/30/2026	4.7%	11.8%	1.92
Continuing Period	4.0%	12.6%	2.05

Period	Invested Capital	Net Claims	Price per share
Base Year	$1,216.19	$33.71	$47.97
11/30/2017	$1,241.20	$7.13	$54.60
11/30/2018	$1,195.58	-$31.08	$61.47
11/30/2019	$790.02	-$66.86	$69.15
11/30/2020	$799.76	-$123.38	$77.71
11/30/2021	$793.24	-$215.64	$87.18
11/30/2022	$860.69	-$340.81	$97.57
11/30/2023	$919.00	-$524.69	$109.42
11/30/2024	$997.63	-$729.31	$121.48
11/30/2025	$1,084.34	-$978.81	$134.36
11/30/2026	$1,165.25	-$1,274.94	$147.97
Continuing Period			