BARRON'S

AAR: A Smoother Flight

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Tied to the ups and downs of the airline industry, the fortunes of AAR understandably have been cyclical. But the supplier of aviation products and services appears to be winging toward sustainable earnings growth, and it has three powerful allies in its quest. The first is the airline industry's boom. The second is super-heated demand for new aircraft, which is expected to continue for years. And the third is the growing trend toward the outsourcing of maintenance by civilian carriers and the U.S. military -- both intent on cutting costs.

David P. Storch, AAR's president and CEO, sees annual sales rising by at least 15%, on average, for a number of years. If so, that could mean net of $3 a share or more four or five years from now -- triple fiscal 1996's $1.

For the current fiscal year, ending May 30, analysts, according to First Call, expect the company to earn $1.37 a share; for fiscal '98, $1.70. But Storch observes that "our style is to top the estimates."

Doing so isn't always possible, however.

Back in the early 'Nineties, after turning in record results, AAR was caught in the downdraft that pummeled the commercial airline industry and led to the demise or near-death of several carriers. The company was flooded with excess parts and, as a result, was forced to take a substantial writeoff. AAR didn't really rebound until fiscal 1995. By then, the airlines were starting to buy more planes and needed more parts and services.

Now, to make itself less vulnerable to the boom-and-bust plane cycle, AAR is focusing on boosting market share, acquiring companies with complementary businesses and lining up long-range contracts.

In fiscal '96, just 10% of sales were done under long-term pacts. By the end of this calendar year, the figure is likely to be around 30%, "This kind of business makes our earnings more predictable," Storch notes.

To illustrate how these deals work, he cites a 10-year contract with General Electric's Aircraft Engines unit. GE has taken over British Airways' engine repair and maintenance operations near Cardiff in the U.K. In turn, AAR is providing a customized inventory-management service, which includes supply and repair of parts and components for engine maintenance. AAR has 18 employees at the facility.

The company has similar long-term deals deals with Northwest Airlines, Sabena, Lufthansa and KLM, and it has another agreement with GE in Brazil. Inventory-management contracts often require AAR to buy parts and keep them in stock, so that they can be immediately installed if needed, thus avoiding downtime for aircraft. Usually, the agreements call for AAR to provide overhaul services as needed.

In addition, the company sells and leases aircraft and aircraft engines. Customers include most of the major airlines (United and Delta are two of AAR's largest clients), as well as regional airlines, private business-aircraft owners and the military.

AAR breaks down revenues into three categories. More than half comes from what is termed "trading," mainly the buying and selling of parts and the sale and leasing of engines and planes. More than 25% is generated by overhaul or repair work on engine and airframe components; the company services most types of large commercial planes. And about 20% of revenues is generated by manufacturing. Among the products AAA makes are onboard cargo-loading systems and floor-maintenance items.

With more than $50 million realized from the sale of common stock in February, AAR is scouting for acquisitions to expand its repair capabilities and its product lines.

In the past, any acquisitions made were comparatively small, but now AAR may be hunting for larger game, particularly in aircraft parts distribution. At the same time, the company has been jettisoning small, marginal operations.

That's helped push up profits, as has an increased emphasis on trimming costs and boosting efficiency. Particularly impressive has been the company's ability to improve inventory turns to three times a year, from two times as recently as fiscal 1994.

Such efforts helped net income to jump 53% in fiscal '96, to $16 million, or $1 a share, as sales rose 12%, to $505 million. Though sales touched a new high, net still fell shy of the peak $25.6 million, reached in fiscal 1990.

One cloud on the horizon, it would seem, is Boeing's recent decision to provide aircraft-maintenance services, a move that some observers feel may be tied to aircraft orders. Although the giant plane maker has indicated that it will move cautiously in this arena -- it doesn't want to alienate some companies that buy its planes and also provide services for other carriers -- its sheer size raises questions for established rivals. However, Storch says: "We don't see Boeing as a threat in this area." He reckons that it might go after certain major maintenance work, but still would have to depend on the likes of AAR for many components and services.

MARKET ACTION

-- After rapidly losing altitude for four years, AAR stock started climbing at the beginning of 1996, in line with a recovery in the company's earnings. Last year's 37% jump, to 30 1/4, outpaced the overall market's gain. This year, however, AAR stock hasn't made much headway, and recently has been trading below 30. The sale of additional shares may have cooled investor enthusiasm. But some analysts remain bullish, expecting the stock to return to its 1989 peak of 37 1/2 within a year or two and more than double in five years.

AAR

(AIR -- NYSE)

SHAREHOLDER DATA

Market Value	$560 mil.
Shares Outstanding	18.1 mil.
Average Daily Volume	20,000 shares
Insider Trading	
(shrs., last 6 months)	None
Institutional Holdings	80%
DIVIDENDS	
Current Rate	$0.48
Current Rate Yield	1.6%

KEY DATA

Profit Margin	3.2%
Return on Equity	8.2%
Return on Capital	7.1%
Debt-to-Equity	45%
Interest Coverage	4.0
Business: Aircraft services	
Headquarters: Wood Dale, Ill.	
Recent Stock Price: 29 3/4	

VIEW FROM THE TOP
Something To Stand On

-- AAR will give a good account of itself as the aircraft parts and services industry undergoes consolidation, predicts David P. Storch, the company's president and CEO. A handful of comparatively large mergers have taken place or are in the works, and AAR itself is pursuing acquisitions. But Storch believes his operation can stand alone. The key: a reputation gained over 45 years that, he says, lets AAR justifiably call itself a "premier supplier" with 33 facilities in 10 countries. "We have great marketing, technological and financial strengths that help us," he asserts. In an industry that's highly fragmented, those qualities could serve AAR well. Storch has a special reason to prize the company's reputation, given the media focus on aviation safety in the wake of the ValuJet, TWA Flight 800 and other tragedies.

RECENT HISTORY

YEAR(a)	EARNINGS Per Share	REVENUES (millions)	NET INCOME (millions)	BOOK VALUE Per Share
1996	$1.00	$505	$16.0	$12.79
1995	0.66	451	10.5	12.35
1994	0.60	408	9.5	11.91
1993	(b)0.39	383	(b)6.3	11.90

a-Year ends May 31; b-before restructuring charge.

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